85-1079 (1)

No.

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

AMERICAN POUCH FOOD CO., INC.,
Debtor In Possession,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether the Government is required to comply with the filing requirements of the Uniform Commercial Code in order to perfect, as against third parties, its rights under the typical title-vesting clause of a Government procurement contract.

2. Whether such a title-vesting clause transfers absolute title to, or only an unperfected security interest in, the materials held, produced or acquired under a Government procurement contract.

3. Whether the Government may enforce an unrecorded security interest in such materials acquired under a Government contract to the detriment of innocent third parties who extend credit to the contractor.

LIST OF PARTIES

The only parties to the proceeding in the Court of Appeals were those whose names appear in the caption to wit: the United

States of America, and American Pouch Foods, Inc. (Pouch). Pouch was and is a party in its capacity as debtor in possession pursuant to Section 1107 of the Bankruptcy Code. Progressive Land Developers, Inc. and APF International own substantial portions of the stock of Pouch. Pouch has no subsidiaries. Progressive Land Developers, Inc. is affiliated with one or more of the various entities commonly known as the American Black Muslim Movement.

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No.

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1985

AMERICAN POUCH FOOD CO., INC.,
Debtor In Possession,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petitioner, American Pouch Food Co., Inc. ("Pouch"), respectfully prays that a Writ of Certiorari issue to review the judgment of the U.S. Court of Appeals for the Seventh Circuit which was entered in this proceeding on July 30, 1985.

OPINION BELOW

The opinion of the U.S. Court of Appeals for the Seventh Circuit (A-1 to A-50)[1] is reported at 769 F.2d 1190. The decision of the United States District Court (A-51 to A-89) is reported at 30 B.R. 1015. The opinions of the United States Bankruptcy Court (A-92 to A-107) are not reported.

JURISDICTION

The judgment of the Court of Appeals (A-1 to A-50) was entered on July 30, 1985. The Court of Appeals denied rehearing (A-110 to A-111) on September 24, 1985.

The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

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[1] Pages A-1 to A-116 inclusive constitute the appendix to this Petition.

The Statutory Provisions which the case involves are:

10 U.S.C. §2307. Advance Payments.

11 U.S.C. §544(a)

11 U.S.C. §1107(a)

Uniform Commercial Code §9-301.

These provisions set forth at pages A-112 through A-116.

STATEMENT OF THE CASE

In January, 1977, Pouch, a minority-owned business, entered into a government procurement contract with the Defense Logistics Agency to produce approximately $22 million worth of combat rations for the U.S. Army.

The contract, among other things, permitted the Government's contracting officer, to make "progress payments" to Pouch under a formula in the contract. The contract also contained a typical "title-vesting clause" provided in substance that, upon the

signing of the contract, title to all parts, materials, inventories, and work in process, acquired or produced by Pouch and allocable or properly chargeable to the contract immediately vested in the Government. The admitted purpose of the title-vesting clause was to protect the Government against loss or damage if Pouch breached any or all of its contractual obligations.

From January 1979 to November 1980, Pouch undertook to produce the combat rations. Towards that end, it acquired specialized manufacturing facilities, purchased materials and supplies,and retained a substantial labor force. In the process, it incurred liabilities to numerous third parties of many millions of dollars. Pursuant to the terms of the contract, Pouch received "progress payments" totally approximately $14 million.

At no time did the Government record or give any other public notice of the interest which it asserted in Pouch's property pursuant to the title-vesting clause.

On November 10, 1980, Pouch filed a petition in the United States Bankruptcy Court for reorganization under Chapter 11 of Title 11 of the United States Code (11 U.S.C. §§1ff). No trustee was ever appointed and Pouch remained in possession of its property, as debtor in possession, pursuant to 11 U.S.C. §1107. Shortly thereafter, the Government filed an action in the Bankruptcy Court asserting title to, and a right to immediate possession of, certain food supplies and inventory acquired or produced by Pouch in connection with its performance under the procurement contract. Pouch filed an answer refuting the Government's claim to title and a counterclaim for damages alleging

that the Government had wrongfully breached its contractual obligations to Pouch.

After hearing the Government's case but before hearing any evidence presented by Pouch or any other parties to the litigation, the Bankruptcy Judge entered two separate orders dated February 6, 1981 and March 27, 1981, respectively, finding that the Government had absolute title to the contract goods and granting judgment to the Government for all the relief sought in its Complaint (A-92 to A-96). Pouch appealed both orders to the United States District Court. The District Court consolidated the two appeals.

While the appeals were pending, the Bankruptcy Judge entered a third order, dated June 5, 1981, finding, over the Government's objection, that it had jurisdiction to hear Pouch's counterclaim and that it would exercise that jurisdiction (A-97 to A-100). On May 14, 1982, the Bankruptcy Judge denied

the Government's motion to reconsider that finding (A-101 to A-107).

On January 29, 1982, the District Court ruled that in the light of the existence of certain factual questions, the bankruptcy court's grant of summary judgment was inappropriate and remanded the case for a full hearing on those issues (A-90 to A-91). The Government filed a timely motion for reconsideration.

On February 17, 1983, while the motion for reconsideration was still pending before the District Court, Pouch moved the court to withdraw from the bankruptcy judge the further consideration of Pouch's counterclaim which was still pending and undecided[2].

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[2] Prior to December 24, 1982, the Bankruptcy Court had jurisdiction pursuant to 28 U.S.C. §1471. The District Court at all times had jurisdiction under 28 U.S.C §1334.

(Footnote Continued)

The Government then "renewed" in the District Court its motion to dismiss the counterclaim on the grounds that the District Court lacked jurisdiction and also urged that even if jurisdiction were present, that the Court should abstain from exercising it pursuant to 28 U.S.C. §1471(d).

On June 20, 1983, the District Court issued a Memorandum and Order (A-51 to A-89) which, in effect, ruled for the Government on all counts. It reconsidered its earlier

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(Footnote Continued)

From December 24, 1982, to July 10, 1984, the bankruptcy judges exercised only such jurisdiction as had been obligated to them by the so-called "Model" Rule adopted by the district court after the expiration of the stay of this court's order in Northern Pipeline Construction Co. v. Marathon Pipe Line Co. 458 U.S. 50, 87 (1982), wherein this Court held unconstitutional the broad grant of jurisdiction to bankruptcy judges provided by the Bankruptcy Reform Act of 1978 (P.L. 95-598, approved November 6, 1978). Section C(1) of that Model Rule specifically authorized the District Court at any time to withdraw a proceeding from the Bankruptcy Judge.

ruling of January 29, 1982 (A-90 to A-91), and affirmed the orders of the bankruptcy judge on the ground that the Government had absolute title to the contract materials and was thus entitled to possession. The District Court also abstained from hearing Pouch's counterclaim.

The Court of Appeals for the Seventh Circuit, in a split opinion, affirmed the District Court (A-1 to A-50). Pouch's petition for rehearing and suggestion for rehearing in banc was denied on September 24, 1985, (A-110 to A-111).

REASONS FOR GRANTING THE WRIT

I. THE DECISION OF THE COURT OF APPEALS IS IN CONFLICT WITH PRIOR DECISIONS OF THIS COURT.

There is no question that if any party other than the Government were involved in this case, Pouch would have prevailed. Pouch, as debtor in possession, has all the

rights and powers of a creditor with a judicial lien as of the date of bankruptcy. 11 U.S.C. §§544(a), 1107(a). A private party asserting rights under a "title-vesting" clause, such as that invoked by the Government would invariably be held to have only a lien or security interest. In re American Pouch Foods, Inc., 769 F.2d 1190, 1193 (7th Cir. 1985) (a-9 to A-10) Ill. Uniform Comm. Code, Ill. Rev. Stat. Ch. 26 §§ 1-201(37), 9-102, and 9-202. In the absence of perfection by filing a financing statement that security interest would be inferior to Pouch's statutory judicial lien. Ill. Uniform Commercial Code, Ch. 26, §9-301.

The Court of Appeals below reached the opposite result by concluding:

A. That the determination of the relative rights of Pouch and the Government was essentially a question of federal law.

B. That federal law precludes invocation or application of those provisions of the Uniform

> Commercial Code which govern the creation and perfection of security interests in personal property.

The latter conclusion was clearly inconsistent and in conflict with applicable decisions of this Court. Moreover, it is inconsistent with the overriding policy against secret liens which is a touchstone of both the federal bankruptcy laws (Cf. 11 U.S.C. §544(a), A-114), and decisions of this Court and lower federal courts.

Since 1979 this Court has mandated that state law, particularly the Uniform Commercial Code ("UCC") be applied as the rule of decision to determine competing rights of parties involved in nationwide Government programs, unless there is a federal statute to the contrary, United States v. Kimbell Foods, Inc., 440 U.S. 715, 729 (1979); Hercoform, Inc. v. Chicago Title Insurance Co, 441 U.S. 901 (1979).

The leading case in this area is the unanimous decision reached by this Court in United States v. Kimbell Foods, Inc., 440 U.S. 715 (1979). There, the Government contended that state commercial codes[3] did not govern the relative priority, as against private lienors, of its liens securing repayment of loans made under programs administered by the Small Business Administration or the Farmer's Home Administration. This Court categorically rejected that contention, saying at page 729:

> "Because the state commercial codes 'furnish convenient solutions in no way inconsistent with adequate protection of the federal interest[s]'...we decline to override intricate state laws of general

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[3] Every state, except Louisiana, has adopted with relatively minor varations, the statute known as the Uniform Commercial Code. Those sections dealing with creation and perfection of security interests are virtually identical from state to state. In re American Pouch Food Co., Inc., (Swygert, J. Dissenting, 769 F.2d 1190, 1200 (7th Cir. 1985) (A-42).

applicability on which private creditors base their daily commercial transactions." (Emphasis added).

Kimbell holds that state law, i.e., the Uniform Commercial Code, should constitute the rule of decision in a commercial dispute involving a Government program whenever:

1. there is no Congressional directive to the contrary;

2. application of the State Law will not defeat the need for uniformity or frustrate specific objections of the Government's program; or

3. application of Federal "common law" instead of State Law would dispute important commercial relationships.

Kimbell was specifically followed by this Court in Hercoform, Inc. v. Chicago Title Insurance Co., 441 U.S. 901 (1979) summarily reversing a First Circuit opinion which had granted priority to a Government lien under principles of general federal law, (Chicago Title Insurance Co. v. Sherred Village Associates, 568 F.2d 217 (1st Cir. 1978).

All of the Kimbell pre-requisites have been met in this case. Nevertheless, the majority of the Court of Appeals held that the Kimbell rule did not apply to a "title vesting" clause in a defense contract. In that respect, we submit, the majority was in error.

As the majority itself acknowledged, 769 F.2d at 1193 (A-9 to A-10) under the entire body of statutory and case law applicable to private contracts, title vesting clauses of the type involved here are uniformly construed as creating only a security interest, regardless of the actual language involved. Particularly where the rights of third parties are involved[4], the courts

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[4] Pouch, as debtor in possession, being vested with all the rights and subject to substantially all the duties of a trustee in bankruptcy is a fiduciary for all creditors and other parties interested in the

(Footnote Continued)

consistently look to the substance rather than the form of the transaction. In the absence of a specific Congressional directive to the contrary[5], this Court, in Kimbell has expressly directed that no different approach be taken just because the Government is a party litigant.

II. THE DECISION OF THE COURT OF APPEALS IS IN IRRECONCILABLE CONFLICT WITH DECISIONS OF THE SECOND AND TENTH CIRCUITS

(Footnote Continued)
estate. (11 U.S.C. §§544(a), 1107(a)) (A-114 to A-115).

[5]The majority of the Court of Appeals implied, 769 F.2d at 1194 (A-14 to A-15) that 10 U.S.C. §2307 (A-112 to A-113) constitutes a Congressional directive that the title-vesting clause be construed literally. Section 2307, however, really directs just the opposite since it specifically requires that as a prerequisite to advance payments that the contractor give adequate security which may be in the form of a lien on the property acquired. The title-vesting clause is admittedly incorporated in Government contracts for the specific purpose of providing that type of lien.

Both In re Murdock Mach. and Eng. Co. of Utah, 620 F.2d 767 (10 Cir. 1980) and United States v. Lennox Metal Manufacturing Co., 225 F.2d 302, 317 (2 Cir. 1955) squarely conflict with the decision of the Court of Appeals in this case.

In Murdock, the Court was faced with a contest between the Government claiming ownership to property under a "title-vesting" clause and a seller seeking reclamation under Section 2-702 of the Uniform Commercial Code. The Murdock Court, at page 772, made the following comments which are directly applicable to the instant case.

> "Many of the reasons which support the holding in Kimbell Foods persuade us that we must adopt state law as the rule of decision in this case. State commercial codes control the mainstream of business life in this country. These codified rights and duties allow business to work within the framework of a settled, predictable environment. Thus, businessmen rely on the availability of those rights and duties unless otherwise agreed."

* * *

"We recognize that the United States must have the means to acquire materials necessary for defense and other governmental purposes. Nevertheless, we believe the government is capable of protecting itself within the framework of state commercial law." (Emphasis added).

Murdock thus stands squarely for the proposition which the majority below rejected - viz., that Kimbell compels the application of state law as the rule of decision with respect to Government title-vesting clauses just as it does to any other security device[6].

Similarly, in U.S. v. Lennox Metal Manufacturing Company, Inc., 225 F.2d 302, 317 (1955), the Second Circuit characterized the Government's interest under a title-vesting

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[6] The Murdock court did not get into the question of nomenclature. By finding the Government's title to be inferior to the reclaiming seller, however, it obviously found that "title" not to be absolute, but rather a type of security device.

clause[7] as being in the nature as an "equitable lien" which could not be enforced, even though the Government had made partial payments to the contractor, unless and until the contractor committed a breach of contract. The Court of Appeals in this case specifically rejected, and refused to follow, the Lennox decision. 769 F.2d at 1196-97 (A-22 to A-25).

In order to resolve the clear conflict among the circuits on the effect and interpretation of a title-vesting clause, it is

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[7] The Lennox contract differed from that involved here in that, by its terms, the title-vesting clause (there called a partial payment clause) only took effect after partial payments had commenced. That should afford no basis for distinction on the facts of this case, since the intent of the clause in the Pouch contract was admittedly to protect the Government against loss if partial payments were actually made. Cf. 10 U.S.C. §2307 (A-112 to A-113).

essential that certiorari be granted by this Court[8].

III. THE DECISION OF THE COURT OF APPEALS INVOLVES AN UNUSUALLY IMPORTANT QUESTION OF FEDERAL LAW

This case presents a head-on collision between two conflicting philosophies, both of which have been endorsed, on various occasions, by Congress and the judiciary. One policy, out of concern for federal

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[8] The decision of the Court of Appeals is also inconsistent with the reasoning -- although not the result --of Marine Midland Bank v. United States, 687 F.2d 395 (Ct. Cl. 1982). In Marine Midland, the court specifically found that the Government's interest under a title-vesting clause was nothing more than a security interest (687 F.2d at 398-390, 401, 403). The court, held, however, that this security interest, under applicable federal law, should be paramount to the "liens" (sic) of general creditors, 678 F.2d 404. Although we do not agree with, and would urge this court to overrule, this latter holding of Marine Midland, we submit that the Marine Midland opinion does furnish additional evidence of a very confused state of the law which should be cleared by a definitive decision of this Court.

revenue, grants special treatment and consideration to the Government when it enters the world of private commerce. The second and, we submit, more appropriate philosophy is that which abhors the recognition and/or enforcement of "secret" liens against property of insolvent estates. The strong trend, at least until now has been to weaken and dilute the concept of Government supremacy and to strengthen the policy against secret liens. It is that policy which underlies the decision of this court in United States v. Kimbell Foods, Inc., supra, 440 U.S. 715, 728-729 (1979), as well as those cases in which other Courts of Appeals have insisted that the Government, when it enters the marketplace, be bound by the same rules which govern the business relationships among private citizens. In re Murdock Machine & Engineering Co. of Utah, 620 F.2d (10th Cir. 1980), United States v. Lennox Metal

Manufacturing Co., 225 F.2d 302 (2d Cir. 1955). That same policy underlay the decision of this Court in United States v. Speers, 382 U.S. 266, 275 where, in holding an unrecorded tax lien to be invalid against a trustee in bankruptcy, this Court pointedly noted that

> "The question. . . . is whether the Government, unlike other creditors, and contrary to the general policy against secret liens, should be given the advantage of a lien which it has not recorded as of the date of bankruptcy."

There is simply no valid ground why an unrecorded "title-vesting" clause should enjoy any greater status in bankruptcy than does an unrecorded tax lien -- particularly inasmuch as Congress in the 1978 Bankruptcy Code, specifically granted priority to tax claims but deleted the priority which Government contract claims had previously enjoyed at 11 U.S.C. §507 by the former Bankruptcy Act §64a.

It is hardly an undue burden on the Government to require it to do what every other secured creditor must do -- viz., comply with the simple recording requirements of the U.C.C. On the other hand, to exempt the Government from those requirements, would have the devastating effect which Judge Swygert, dissenting, graphically depicted in these words (A-44 to A-45).

"The application of a federal rule (excluding public filing or recording) would disrupt commercial relationships predicated on State law. With an annual budget that will soon exceed $300 billion, See Boyd, Leaders Report Budget Accord with President, NY Times, July 10, 1985, at 11,col. 5, the Defense Department has an enormous, brooding presence in the marketplace. Yet, it is not always obvious that the military is involved in a particular transaction. There is nothing inherent in the purchase of such pedestrian goods as food in the case at bar or steel in Murdock that alerts the seller to the military's presence. Thus, allowing the military to hold enormous secret liens wreaks havoc with the expectations of the business community. "Mindful of the burdens of time and expense such investigations [of the possibility of the military's interest in a transaction] would impose on our nation's commerce, and the injustice which would result by dealing government 'wild cards' to businessmen at random," I am "not inclined to

create a special commercial law for the government's benefit." Murdock, 620 F.2d at 772.

CONCLUSION

WHEREFORE, Pouch on behalf of itself and as the statutory representative (11 U.S.C. §§544(a), 1107(a) (A-114 to A-115) of all its creditors prays that a writ of certiorari be issued to review the decision of the Court of Appeals in order to eliminate the conflict with the above cited opinions of this Court and other Courts of Appeals and in order to prevent the serious "disruption of commercial relationships" which will otherwise result.

Respectfully submitted,

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December 20, 1985

APPENDIX

In the

UNITED STATES COURT OF APPEALS

For the Seventh Circuit

No. 83-2530

In Re: American Pouch Foods, Inc.

Debtor-Appellant.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division
Nos. 81-C-1616 & 81-C-2914,
Nicholas J. Bua, Judge

ARGUED SEPTEMBER 13, 1984-
-DECIDED JULY 30, 1985

Before FLAUM, Circuit Judge, and SWYGERT and FAIRCHILD, Senior Circuit Judges.

FAIRCHILD, Senior Circuit Judge. In a reorganization proceeding under Chapter 11 of the Bankruptcy Code the district court decided, in response to a complaint by the United States, that the United States held absolute title (and right to possession) to certain goods in the possession of the

Debtor, American Pouch Foods, Inc. (Pouch). The court abstained from hearing Pouch's counterclaim. In re American Pouch Foods, Inc., 30 B.R. 1015 (Bankr. N.D. Ill. 1983). Pouch appeals. We affirm.

In January 1979, Pouch entered into a procurement contract with the United States Defense Logistics Agency (Government). The contract called for Pouch to produce combat rations, known as "Meals, Ready to Eat" (Food Pouches), for use by branches of the Armed Services. The contract gave Pouch the right to progress payments upon request, not more often than bi-weekly. The payments were limited to 90% of Pouch's cost incurred to the date of payment. The so-called title vesting (2) clause of the progress payment part of the contract provided that title to all parts, materials, inventories, work in process and various other categories

immediately vested in the Government[1]. Other provisions gave the Government the right to terminate for default (or for convenience of the Government) and to require delivery to it of completed supplies and manufacturing materials. The contract also provided that

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[1]The title vesting clause in the contract provided, in pertinent part:

(d) Title. Immediately, upon the date of this contract, title to all parts; materials; inventories; work in progress; ... theretofore acquired or produced by the Contractor and allocable or properly chargeable to this Contract under sound and generally accepted accounting principles and shall forthwith vest in the Government; and title to all like property thereafter acquired or produced by the Contractor and allocable or properly chargeable to this contract as aforesaid shall forthwith vest in the Government upon said acquisition, production or allocation. Notwithstanding that title to property is in the Government through the operation of this clause, the handling and disposition of such property shall be determined by applicable provisions of this contract such as: the Default clause and paragraph (h) of this clause; Termination for Convenience of the Government clause; and the Special Tooling clause....

if, after notice of termination for default, it was determined that Pouch was not in default or that default was excusable, the rights and obligations of the parties would be the same as if the notice of termination had been for convenience of the Government.

After making approximately $13 million in progress payments the Government terminated the contract for default. The Government claimed that Pouch had not complied with required production schedules. On Novem- (3) ber 10, 1980, three days after the contract was terminated, Pouch filed a petition for reorganization under Chapter 11 of the Bankruptcy Code, 11 U.S.C. §101 et seq. The Government claimed ownership and possession of all the property allocable to the contract in Pouch's possession or stored at warehouse facilities on its behalf. On December 5, 1980 the Government filed an adversary

complaint in bankruptcy court to obtain possession.

Pouch filed an answer principally alleging wrongful termination of the contract and that the Government's title was a security interest not perfected as required by law and subordinate to the rights of the debtor and creditors. Pouch filed a counterclaim seeking damages arising from wrongful termination of the contract.

On February 9, 1981, the bankruptcy court held that, as a matter of law, the Government had absolute title to the property in question and was entitled to repossess it.

While the appeals were pending the bankruptcy court held that it had jurisdiction to hear Pouch's counterclaim even though the Armed Services Board of Contract Appeals had concurrent jurisdiction over the claim.

After the district court decided that questions of fact must be determined and remanded to the bankruptcy court, the Government filed a motion for reconsideration. In 1983, before that motion was decided, Pouch filed a motion in the district court to withdraw from the bankruptcy court the reference of the Government's adversary proceeding. That motion was granted.

Upon reconsideration the district court held that, as a matter of law, the Government had absolute title to all of the property covered by the title vesting clause. In re American Pouch Foods, Inc., 30 B.R. at 1023. The court also noted that if the Government only took a lien on the allocable property, to secure its progress payments, the lien would be paramount to any other liens. Id. The court (4) decided to abstain from hearing Pouch's counterclaim because the issue was

better brought before the Armed Services Board of Contract Appeals. Id. at 1024.

I

Pouch is a debtor in possession in a reorganization proceeding and as such claims, under 11 U.S.C. §544(a)(1), the rights and powers of a creditor with a judicial lien. Pouch argues that the title vesting clause in the contract only gave the Government a security interest (lien) in the contract property and that Pouch's hypothetical lien has priority because the Government's lien was not perfected in compliance with the Illinois Commercial Code.

Pouch relies on United States v. Kimbell Foods, Inc., 440 U.S. 715 (1979). There the Supreme Court was confronted with the issue of "whether contractual liens arising from certain federal loan programs take precedence over private liens, in the absence of a federal statute setting priorities." 440

U.S. at 718 (footnote omitted). The loan programs involved were those of the Small Business Administration and Farmers Home Administration. The Court found it clear that priority of liens stemming from federal lending programs must be determined with reference to federal law. 440 U.S. at 726. After analysis of the character and purposes of the lending programs, the Court found it prudent in determining priority "to adopt the ready made body of state law as the federal rule of decision until Congress strikes a different accommodation." 440 U.S. at 740 (footnote omitted).

Pouch first contends that the title vesting clause in the Pouch contract creates only a security interest in the Government such as was clearly the case in Kimbell Foods and secondly that the principles applied in Kimbell Foods require application of the Illinois Commercial Code to determine

priority here. It would follow that Pouch's (5) statutory lien as debtor in possession would be superior to the lien of the Government.

We first consider whether the Government has title such that there is no question of priority of liens. The clear and precise language of the contract between Pouch and the Government granted the Government title. Pouch argues that, notwithstanding the language of the contract, given the intent of the parties, the many incidents and risks of ownership retained by Pouch under the contract, and modern theory in the law of secured transactions, the title vesting clause should not be interpreted literally as grant of title to the Government.

We acknowledge, generally, that contract language which purports to place title to goods in a party not in possession of them may well create only a security interest in

that party. See, e.g., Commercial Code provisions, Ill. Rev. Stat. ch. 26, §§ 1-201(37) (Supp. 1985), 9-102 and 9-202 (1974). The terms of this contract left Pouch with many of the incidents and risks of ownership.

Thus there would be considerable reason to treat provisions like these, if found in a private contract, as creating a security interest. On the other hand, this is a contract for the procurement of materials for national defense, with its terms spelled out in the regulations of the Defense Department, 32 C.F.R. §163.79, and a history suggesting a substantial reason for very literal interpretation of the title vesting language.

Since 1823 there has been a federal statute prohibiting advances of public money and payment on contracts in excess of the value of service rendered or goods delivered previously to payment. 3 Stat. 723, Rev.

Stat. §3648 (1873), 31 U.S.C. §529 (1981), 31 U.S.C. §3324 (1983). Apparently there grew up a concept of purchase of unfinished goods in return for progress payments (often, in earlier years, referred to as "partial payments"), and doctrine that this statute is not violated by payment (6) previous to delivery if title to the portion paid for has vested in the Government at the time of payment, or if the articles are then impressed with a valid lien in favor of the Government.

Although the practice has been severely criticized, e.g., McClelland, The Illegality of Progress Payments as a Means of Financing Government Contractors, 33 Notre Dame Law, 380 (1958), the theory had been supported by a 1941 ruling of the Comptroller General, 20 Comp. Gen. 917, 918 (1941), quoted in McClelland, op. cit. p. 389, and by opinions of the Attorney General, cited in Wheland,

Government Supply Contracts: Progress Payments Based on Costs; The New Defense Regulations, 26 Fordham Law Rev. 224, 232 (1957).

In 1911 a statute expressly authorized the Navy to make progress payments (referred to as partial payments) in return for a lien, paramount to all other liens. 37 Stat. 32, 10 U.S.C. §7521.

The First War Powers Act, 55 Stat. 839, §201, December 8, 1941, authorized advance and progress payments on war effort contracts.

Statutory authority for advance payments (but not progress payments) was conferred by §5 of the Armed Services Procurement Act of 1947, 62 Stat. 21, February 19, 1948. Section 5(b) required adequate security and

provided that the contract may include a lien, paramount to all other liens[2].

In 1952 Defense Contract Financing Regulations were issued. 32 C.F.R. Part 82, 17 Fed. Reg. 3581, April 23, 1952. There were references to progress payments as one method of financing, along with advance payments and guaranteed loans. An earlier form of regulations required (7) the vesting of title when progress (partial) payments were made. City of Detroit v. Murray Corp., 355 U.S. 489, 517-18 N.4 (1958) (Whittaker, J., dissenting).

On December 17, 1956, revised Defense Contract Financing Regulations were issued. 32 C.F.R. Part 82, 22 Fed. Reg. 815, February

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[2]Similar provisions in procurement for agencies other than Armed Services appeared in the Federal Property and Administrative Services Act of 1949, 63 Stat. 377, June 30, 1949.

9, 1957. Subpart E, devoted to Progress Payments Based on Costs, required a title clause virtually the same as now required for Small Business concerns by 32 C.F.R. §163.79 and appearing in the Pouch contract under consideration.

The provision for advance payments was codified as 10 U.S.C. §2307 by 70A Stat. 1, P.L. 84-1028. As codified, §2307(a) authorized advance payments and §2307(c) required adequate security, which may be a lien paramount to any other liens.

Section 2307 was amended in August, 1958, adding express authority to make progress payments, and then, as now, §2307(a)(1) reads:

> (a) The head of any agency may --
>
> (1) make advance, partial, progress, or other payments under contracts for property or services made by the agency;....

P.L. 85-800 §9, 72 Stat. 967, August 28, 1958. No reference to progress payments was

inserted into (c) so that literally the provision requiring security and making the Government lien paramount applies only to advance payments.

The legislative history reported in [1958] U.S. CODE CONG. & AD. NEWS 4021 deals with other considerations, with one exception. It contains a letter from the Comptroller General to the Chairman of the Senate Committee on Government Operations. Among a number of comments, the letter says:

> We believe that the authority to make "progress" payments should not be provided, unless provision is (8) also made to preserve to the Government the right to take title to or receive a lien paramount to all other liens on the property on which it makes a progress payment.

Although Congress inserted no language in response to the suggestion, we can think of no reason why Congress could have intended less protection for the Government when making progress payments than when making advance payments. If the omission of

progress payments from §2307(c) were inadvertent and if the title clause creates only a lien, it would follow that such lien was intended to be paramount. But the 1958 amendment was enacted when the practice of contracting for progress payments in return for title had been followed for many years. Regulations spelling out the practice and the terms of the title clause had been in effect for eighteen months[3]. We conclude that Congress recognized the practice of making progress payments in return for title and in expressly authorizing progress payments intended to validate the practice. Cf. City of Detroit v. Murray Corp., 355 U.S. at 517-18 n.4 (Whittaker, J., dissenting).

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[3]There had been an earlier version as well. City of Detroit v. Murray Corp., 355 U.S. 489, 517-18 n.4 (1958) (Whittaker, J., dissenting).

Strong support for literal interpretation of the title clause as vesting ownership in the Government is found in United States v. Ansonia Brass & Co., 218 U.S. 452 (1910). The decision may not be conclusive, for the property there involved was a dredge, far more identifiable at any stage before completion than the materials and pouches involved here, and the contracts are not identical. The Supreme Court there said, however,

> It is undoubtedly true that the mere facts that the vessel is to be paid for in installments as the work progresses, and to be built under the superintendence of a government inspector, who had power to reject or (9) approve the materials, will not of themselves work the transfer of the title of a vessel to be constructed, in advance of its completion. But it is equally well settled that if the contract is such as to clearly express the intention of the parties that the builder shall sell and the purchaser shall buy the ship before its completion, and at the different stages of its progress, and this purpose is expressed in the words of the contract, it is binding and effectual in law to pass the title.

218 U.S. at 466-67 (citation omitted).

There are a number of other decisions recognizing, or at least consistent with, Government ownership of goods in the possession of others, by virtue of the title vesting clause. City of Detroit v. Murray Corp., 355 U.S. 489 (the majority upheld a local tax on use or possession of property, assuming the property was owned by the Government; the minority concluded that the Government owned the property by virtue of the title vesting clause and considered the tax invalid, 355 U.S. at 514-24); U.S. v. Allegheny County, 322 U.S. 174, 183 (1944); United States v. Digital Products Corp., 624 F.2d 690 (5th Cir. 1980); In re Double H Products Corporation, 462 F.2d 52 (3rd Cir. 1972); Boeing Company v. United States, 338 F.2d 342 (Ct. Cl. 1964); Shepard Engineering Company v. United States, 287 F.2d 737, 741 (8th Cir.), reh'g denied 289 F.2d 681 (1961)

(per curiam); In re American Boiler Works, 220 F.2d 319 (3rd Cir. 1955); In re Read-York, 152 F.2d 313 (7th Cir. 1945); United States v. Buder, 414 F. Supp. 1 (E.D. Mo. 1975), aff'd without opinion, 538 F.2d 333 (8th Cir. 1976); United States v. Ameco Electronic Corporation, 224 F. Supp. 783 (E.D. N.Y. 1963); In re Pamlico Canvas Products, Inc., No. 82-01464-4 (Bankr., E.D. N.C., May 19, 1983); In re Invader Corporation, United States v. Invader Corporation, No. 1-81-00338E (Bankr., W.D. Tex., Jan. 12, 1983); United States v. Metadine Corporation, No. C080 0460 (E.D. N.Y., Apr. 17, 1980).

(10) In In re Murdock Mach. & Eng. Co. of Utah, 620 F.2d 767 (10th Cir. 1980), the court appeared to acknowledge that the title clause made the Government a good faith purchaser for value of goods purchased by the contractor. The seller of the goods, however, had learned of the insolvency of the

contractor and had stopped the goods in transit to the contractor. The court applied the U.C.C., according to the seller the right to stop in transit, superior to the Government's right as good faith purchaser. The decision is consistent with recognition of the Government's title in our present case, unaffected by the debtor's statutory lien.

In Marine Midland Bank v. United States, 687 F.2d 395 (Ct. Cl. 1982), the court read the title vesting clause as creating security for repayment (out of amounts due the contractor at final performance) of the progress payments, which the court deemed loans, rather than partial purchases. Having decided that the Government had only a security interest (as Pouch contends here) the court declined to apply the state U.C.C. as the federal rule of decision governing priority. Emphasizing the need for standardization and uniformity in Government

procurement, as distinguished from the federal loan programs which were the subject of Kimbell Foods, supra, the court chose a rule that "the government's security interest under its title vesting procedures [is] paramount to the liens of general creditors." Id. at 404. We would agree with the latter holding if the Government's interest were only a lien.

We acknowledge the reasonableness of the Marine Midland view if we were considering the title vesting provisions on a clean slate. We do not agree, however, that because the 1958 enactment of express authority to make progress payments removed the original motive for using a title vesting clause, the construction of the clause should change at the time of that enactment. See 687 F.2d at 401. Notwithstanding Judge Bennett's meticulous explication, we see no reason for departure from the consistent

hold- (11) ings before and after 1958 that the title vesting clause is to be taken literally.

We note, however, that application of the Marine Midland rule to the present case would produce the same result we reach, awarding possession to the Government. Pouch does not argue, nor does the record suggest, that the value of the goods exceeds the total of progress payments. Cf. 687 F.2d at 405.

In United States v. Lennox Metal Manufacturing Co., 225 F.2d 302 (2nd Cir. 1955) the court considered a contract providing for progress payments (there called partial payments) and containing a title vesting clause. The Government terminated the contract for default and sued the contractor to recover possession of the property and damages. The district court had found with adequate support that the contractor was not in default, and that foreclosed recovery of

damages. The district court also denied recovery of possession.

Judge Frank wrote the opinion, stating his individual view in Part I. Part II, 225 F.2d beginning at 317, was agreed to by all three judges. The Government contended that upon failure to prove default by the contractor, it had nevertheless brought about a termination for convenience. The contract so provided. The court affirmed the denial of possession, holding in Part II that the Government's refusal to make larger progress payments had been inequitable and such conduct had disentitled it to equitable relief, i.e., "the enforcement of an equitable lien on the [contractor's] property." 225 F.2d at 317. Evidently, although without explanation, the court interpreted the title vesting clause as creating only an equitable lien.

We do not agree. Our interpretation of the contract is that upon termination, whether for default or convenience, the Government becomes entitled to possession of the property to which it has title. The ultimate rights to pecuniary adjustment between the parties will depend (12) upon the type of termination, but the Government is entitled to possession under either type. The Fifth Circuit has held that:

> [I]n cases involving termination of Government contracts, where the product is part of the national defense effort, the jurisdiction of the district courts does not embrace any issue beyond that of title, so long as the Government represents in its complaint that the contract had been terminated. To hold otherwise would permit a contractor to plead and litigate factual issues surrounding the termination, and delay delivery of vitally-needed defense products.

United States v. Digital Products Corp., 624 F.2d 690, 692 (5th Cir. 1980); accord In Re Greenstreet, Inc., 209 F.2d 660, 667 (7th Cir. 1954).

Lennox has not been followed, and has been criticized[4]. Even if a court would apply equitable principles against the Government in a case where extreme unfairness were shown, circumstances of that type have not been suggested here.

II

Pouch filed a counterclaim seeking money damages, alleging that the termination was without just cause, and thus was for the convenience of the Government. The Government asserts sovereign immunity. We need not reach the issue of immunity.

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[4] See Pasley, The Interpretation of Government Contracts: A Plea for Better Understanding, 25 Fordham L. Rev. 211, 230-40 (1956); Wheland, Government Supply Contracts: Progress Payments Based on Costs; The New Defense Regulations, 26 Fordham L. Rev. 224, 241-42 (1957). See also Bachman, Defense Department Contract Financing, 25 Geo. Wash. L. Rev., 228, 234 (1957).

(13) The district court decided to abstain from hearing the counterclaim, concluding that because the Armed Services Board of Contract Appeals and the Court of Claims have expertise in the specialized area of law involved, it would be in the interest of justice for the district court to abstain.

Pouch does not seek review of the abstention decision on its merits, but contends that a particular statute deprived the district court of power to decide to abstain.

Pouch relies upon 28 U.S.C. §1471(d) created by P.L. 95-598 §241(a), November 6, 1978, 92 Stat. 2668, made applicable to former courts of bankruptcy during the transition period by §405(b). Section 405(b) was repealed by P.L. 98-353, §114, 98 Stat. 343, July 10, 1984. Section 113 deprived §241(a) of all other effect.

Section 1471(d) provided:

> Subsection (b) or (c) of this section does not prevent a district court or a bankruptcy court, in the interest of justice, from abstaining from hearing a particular proceeding arising under title 11. Such abstention, or a decision not to abstain, is not reviewable by appeal or otherwise.

Pouch does not argue that its counterclaim was not "a particular proceeding" subject to possible abstention. Rather, Pouch relies on the June 5, 1981 decision of a bankruptcy judge denying the Government's motion to dismiss the counterclaim for lack of jurisdiction and requiring the Government to answer. Pouch interprets this order as a decision not to abstain, and reasons that the district court decision to abstain, June 20, 1983, was a forbidden review of the June 5, 1981 decision of the bankruptcy judge.

The February 1981 decision of the bankruptcy judge that the Government was entitled to possession came before the district court on appeal. It is not clear whether there was also an appeal from the

June 1981 decision of the bankruptcy judge, but as the law then stood, only an (14) appeal could have brought it before the district court. In the posture of appeal, Pouch might well be correct in its contention that the district court could not review the June 1981 decision insofar as it was a decision not to abstain. Other very significant developments intervened.

The first was the 1982 Supreme Court decision that the broad grant of jurisdiction in §1471 was unconstitutional. Northern Pipeline Construction Co. v. Marathon Pipeline Co., 458 U.S. 50, 87 (1982). The Court stayed its judgment until October 4, 1982, in order to give Congress an opportunity to reconstitute the bankruptcy courts or to adopt other valid means of adjudication. The stay was extended until December 24, 1982. 459 U.S. 813 (1982).

In these circumstances, the Judicial Councils of the Circuits directed the district courts to adopt rules to govern bankruptcy cases.

The Emergency Rule adopted by the District Court for the Northern District of Illinois, effective December 25, 1982, provided for the automatic referral of all cases arising under Title 11 and all civil proceedings arising in or related to Title 11 to the bankruptcy judges. (Emergency Rule Section (c)(1).) The Rule also stated that:

> [t]he reference to a bankruptcy judge may be withdrawn by the district court at any time on its motion or on timely motion by a party.... If a reference is withdrawn the district court may retain the entire matter, may refer part of the matter back to the bankruptcy judge, or may refer the entire matter back to the bankruptcy judge.

Rule (c)(2).

In early 1983 the district court had before it the Government's motion to reconsider the decision on appeal from the

February 1981 decision of the bankruptcy judge. (15) Pouch, however, moved to have the reference to the bankruptcy judge withdrawn. The motion was granted February 17, 1983.

The Government argues that the withdrawal of the reference was a recapture by the district court of original jurisdiction and that further proceedings in district court were de novo and not on appeal.

This Court has stated that:

> The Interim Rule adopted by the district courts establishes a system of bankruptcy adjudication whereby the bankruptcy judges act as adjuncts of the Article III district courts. The district courts retain primary jurisdiction over bankruptcy matters while the bankruptcy judges have only derivative and terminable jurisdiction. The bankruptcy judges act as subsidiaries to and only in aid of the district courts by carrying on preliminary procedures and proposing decisions for adoption by the district court. The ultimate adjudicatory determination is reserved to the district judge.

In Re Mark Stewart, 741 F.2d 127, 131 (7th Cir. 1984) (emphasis added and citations

omitted). We think that in these circumstances reconsideration by the district court did not constitute review of the earlier decision on abstaining. The situation was the same as if the district court had itself made the earlier decision. See United States v. Barney, 686 F.2d 102, 107 (2nd Cir. 1982) (judges of coordinate jurisdiction are not bound by other judges' rulings on the same facts; they are free to disregard the decisions if sufficient notice and an opportunity to prepare are given to concerned parties); Champaign-Urbana News, Etc. v. J.L. Cummins, 632 F.2d 680, 683 (7th Cir. 1980) (as modified on denial of rehearing and rehearing en banc) (a second judge, upon the first judge obtaining senior status, is not precluded by the "law of the case" doctrine from coming to a different conclusion from that of the first judge on the same facts).

(16) Pouch apparently reasons that §1471(d) prohibits us from reviewing the merits of the district court's decision to abstain, but that we could properly vacate that decision if §1471(d) prohibited the district court from making it. Assuming we have that power we conclude that the district court was free to reconsider the matter of abstention without engaging in forbidden review.

We have already noted that on July 10, 1984, §1471(d) ceased to have any effect. At that date this appeal had been taken, but was not yet argued. On July 10, 1984 §101(a) of P.L. 98-353 added subsection (c) to 28 U.S.C. §1334. Subsections (c)(1) and (2) contain provisions similar to §1471 with respect to abstention. The prohibition of review is in (c)(2). Section 122(b) of P.L. 98-353, however, provides that (c)(2) shall not apply

with respect to cases pending on July 10, 1984.

Assuming that we presently have jurisdiction to review the district court decision to abstain, we find no abuse of direction.

The judgment appealed from is AFFIRMED.

SWYGERT, Senior Circuit Judge, dissenting. Because this case concerns the rights of the United States arising under a nationwide federal program, there is no question that federal law governs. United States v. Kimbell Foods, Inc., 440 U.S. 715, 726-27 (1979). Yet, in defining the rule of decision that gives content to that federal common law, this court must often resort to State law, particularly where there is no express congressional directive to the contrary and where any other rule would disrupt commercial relations predicated on State law. See id. at 728-29, 740. I would

apply Illinois' Uniform Commercial Code as the rule of decision and would hold that the United (17) States owned only an unperfected security interest in the seized assets.

In Kimbell, 440 U.S. at 728-29, 740, the Supreme Court held that State law should apply as the rule of decision in a commercial dispute involving a nationwide federal program if (1) there is no congressional directive to the contrary, (2) the federal program in question need not be uniform in character nationwide, (3) the application of State law would not frustrate specific objectives of the program, and (4) the application of a federal rule would disrupt commercial relationships predicated on State law. The majority holds, under two alternative theories, that the first criterion was not satisfied in the case at bar.

First, the majority holds that by passing legislation in 1958 expressly

authorizing "progress payments," see 10 U.S.C. §2307(a)(1) (1982), Congress necessarily incorporated as binding federal law the past practices that defined the term. Because the United States had always purported to take absolute title -- rather than a security interest -- in the parts, work in process, and inventories of government contractors in return for progress payments, Congress must have intended to incorporate this practice into the law. See ante at 5-10.

Yet, as the majority's thorough historical review demonstrates, ante at 5-8, the 1958 statute simply marked the culmination of Congress' long retreat from its former prohibition of advances of public money to government contractors in excess of the value of services already intent to legalize the practice of advance payments in general. The statute and legislative history are silent on

the question of whether the title-vesting clause that traditionally accompanied progress payments should be interpreted literally or as a de facto security interest. The only relevant concern of Congress was that the federal government be permitted to pay money in advance of contract performance; the specifics of defining the effect (18) and ramifications of various contractual alternatives, such as progress payments, were left open[5].

Congressional silence on such issues should not be interpreted as an invitation to the courts to fashion a uniform federal

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[5]Thus, in explaining its legalization of advance payments, the Senate Report simply cited the need for a "modernized code of procurement procedures." S. Rep. No. 2201, 85th Cong., 2d Sess., reprinted in 1958 U.S. Code Cong. & Ad. News 4021, 4024. Congress approved the principle of advance payments as consistent with modern commercial practice, but left to others the task of defining the specific rules governing advance payments.

common law. The "guiding principle" in deciding whether to fashion rules of federal common law or to incorporate State law is that a "significant conflict between some federal policy or interest and the use of state law in the premises must first be specifically shown." Wallis v. Pan American Petroleum Corp., 384 U.S. 63, 68 (1966). It is not enough that Congress could have readily enacted a complete code of law governing these commercial transactions better than the available State law; the "latent federal power . . . to displace state law is primarily a decision for Congress," and Congress must explicitly indicate its intent to exercise this power. See id.

The second theory advanced by the majority, see ante at 10-11, is that assuming the Government's interest should be defined as a security interest, pursuant to well-established principles of State commercial

law, Congress has already provided by statute the governing law of priority. In authorizing liens to secure "advance" payments, Congress required that such liens be "paramount to any other lien." 10 U.S.C. §2307(c) (1982). Despite the historical differences between "advance" and "progress" payments, Congress must have used the term "advance payments" in the generic sense to include all kinds of payments in advance of full contract performance. "[W]e can think of no reason why Congress could have intended (19) less protection for the Government when making progress payments than when making advance payments." Ante at 8.

I agree. Because Congress has expressly provided that government liens be paramount, this directive must be incorporated as a rule of priority. But one rule of priority does not make a commercial code. Congress provided no direction on a myriad of issues that

must be decided in this case and in other commercial cases. There are no guidelines as to how to judge the validity of a government lien, when it attaches, or what prerequisites--such as perfection--must be met before a particular government lien can be enforced as a paramount lien. I would hold that State law provides the rule of decision in determining the creation, validity, and perfection of government liens.

It is not incongruous to hold that different sources of law govern various, but related, aspects of a single commercial transaction. Kimbell does not require that a commercial transaction be governed entirely by federal common law or entirely by State law. Indeed, the Supreme Court has stressed that "[e]ven where there is related federal legislation in an area . . . it must be remembered that 'Congress acts . . . against the background of the total corpus juris of

the states.'" Wallis, 384 U.S. at 68 (quoting Hart & Wechsler, The Federal Courts and the Federal System 435 (1953)). In Wallis the Court adopted the kind of hybrid law I propose in the case at bar. The Court held that while federal law governs the ability of private parties to assign oil and gas leases, State law governs the validity of a particular transfer between two parties. Similarly, this court in United States v. Meadors, 753 F.2d 590, 592 (7th Cir. 1985), selectively applied State law to only a few of the specific issues of commercial law presented in that case. Such hybrid law is consistent with our conception of federal regulation as often "interstitial in nature, enacted against a background of state law and building on state (20) law relationships." Comment, Adopting State Law as the Federal Rule of Decision: A Proposed Test, 43 U. Chi. L. Rev., 823, 829 (1976); accord

Mishkin, The Variousness of "Federal Law": Competence and Discretion in the Choice of National and State Rules for Decision, 105 U. Penn. L. Rev. 797, 804-05 (1957) ("Most pervasive, perhaps, is the principle that a decision to apply state law as a matter of federal judicial incorporation may frequently be made as to a single issue at a time.").

The first prong of Kimbell is therefore satisfied: there has been no congressional directive regarding what law should govern the creation, validity, and perfection of a government lien. Turning to the second prong, I would follow the Tenth Circuit's holding that the government's interest in a uniform federal law for military procurement would not be compromised by the incorporation of the Uniform Commercial Code ("UCC") as the rule of decision. In re Murdock Machine & Engineering Co. of Utah, 620 F.2d 767, 772-73 (10th Cir. 1980). The need for uniformity is

already satisfied by State law itself, inasmuch as every State except Louisiana has enacted the UCC. See J. White & R. Summers, Handbook of the Law Under the Uniform Commercial Code §1 at 1 & n..1 (2d ed. 1980). Here, as in Kimbell, 440 U.S. at 732-33 & n.28, there is no evidence that the "minor "variations" in Article 9 of the UCC from State to State would hinder the government's national program. That the government program here involves national defense does not alter this conclusion. I fail to see how the trivial inconveniences attending compliance with the essentially uniform recording requirements of the States somehow threaten national security. Accord Murdock, 620 F.2d at 772-73.

As for the third prong of Kimbell, it can be argued that destroying the priority of federal liens by subjecting the federal government to State recording requirements

would frustrate a specific objective to the federal procurement effort: to ensure that federal liens are paramount to (21) all others. It is true that incorporating State law as the rule of decision in the case at bar may effectively destroy the value of the Government's claim to the seized assets. Yet, if noncompliance with State recording laws would effectively defeat the Federal government's ability to claim a paramount lien, certainly compliance would not[6]. The Government's assertion at oral argument that incorporating the UCC into federal law would destroy the value of billions of dollars of government liens is an argument against

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[6]I would therefore hold that if the government executes a proper security agreement and if its lien attaches and is perfected, then the government holds a paramount lien--superior in priority even to the perfected security interests of other creditors.

retroactive application of such a rule, not an argument that the government would be unable to protect its interests under the UCC in the future.

There is no question that the fourth prong of Kimbell is satisfied. The application of a federal rule would disrupt commercial relationships predicated on State law. With an annual budget that will soon exceed $300 billion, see Boyd, Leaders Report Budget Accord with President, N.Y. Times, July 10, 1985, at 11, col. 5, the Defense Department has an enormous, brooding presence in the marketplace. Yet, it is not always obvious that the military is involved in a particular transaction. There is nothing inherent in the purchase of such pedestrian goods as food in the case at bar or steel in Murdock that alerts the seller to the military's presence. Thus, allowing the military to hold enormous secret liens wreaks havoc

with the expectations of the business community. "Mindful of the burdens of time and expense such investigations [of the possibility of the military's interest in a transaction] would impose on our nation's commerce, and the injustice which would result by dealing government 'wild cards' to businessmen at random," I am "not inclined to create a special commercial law for the government's benefit." Murdock, 620 F.2d at 772.

(22) I would therefore hold that State law provides the rule of decision governing the creation and perfection of the Government's security interest. As the majority apparently agrees, see ante at 5, there can be little doubt that the title-vesting clause created a security interest. Illinois' UCC defines a secured transaction to include "any transaction (regardless of its form) which is intended to create a security interest in

personal property or fixtures." Ill. Ann. Stat. ch. 26, §9-102(1)(a) (Smith-Hurd 1974) ("Ill. UCC"). Thus, the Government's characterization of its interest as one of absolute title is irrelevant; it is the intent of the parties, not the form of the transaction, that is dispositive[7]. Here, the many incidents of ownership conferred on Pouch[8]

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[7]To be sure, the Supreme Court in United States v. Ansonia Brass & Copper Co., 218 U.S. 452, 466-67 (1910), interpreted the title-vesting clause literally. Yet, this holding simply provided a rule of federal common law. Because Kimbell, properly applied, requires the court to rely on State law in the case at bar, the Ansonia Brass rule is irrelevant.

[8]For example, the contract provided that Pouch (1) retain possession of the contract property with full authority to process it, (2) bear the risk of loss, (3) sell any production scrap, and (4) gain title to property obtained from suppliers as soon as all progress payments were repaid or as soon as the contract deliveries were made. Curiously enough, the contract also required Pouch to convey title to the Government if the contract was terminated "for cause" or

(Footnote Continued)

combined with the federal contract officer's testimony that the purpose of the title-vesting clause was to secure performance, see Appellant's Brief at 26-27 (quoting Transcript), compel the conclusion that the parties intend the Government to take only a security interest.

It is undisputed that the Government failed to file a financing statement pursuant to Ill. UCC §§9-103, 9-302, (23) 9-401-03. The Government therefore held only an unperfected security interest in the seized assets. Id. at §9-303. To be sure, this did not render the security agreement invalid or unenforceable. And it can be argued that as long as the Government's security interest is valid under State law, the federal rule of

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(Footnote Continued)
"for convenience." See Appellant's Supplemental Appendix at 63a (reprinting contract).

priority should apply to render the Government's lien paramount. Yet, the federal statute is so sparse as to what prerequisite should be met to create a valid and enforceable paramount lien that I would define the State perfection requirement as such as prerequisite. Only in this way can federal legislation that is interstitial in nature be brought into harmony with the broad body of State law that remains in force and effect until expressly replaced with more comprehensive federal legislation. See supra at 19-20.

I would hold then, that before the Government seized Pouch's assets, it held an unperfected security interest. As such, its rights were subordinate to those of a variety



of other creditors, including the debtor-in-possession. See Ill. UCC §9-301(1), (3).[9]

It should be noted, however, that once the Government came into possession of the collateral, no creditor, regardless of its superior claim of right, could compel repossession. Such repossession would be inconsistent with the sovereignty of the United States. Rather, the remedy (24) for those who held superior claims to the collateral is

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[9]On the other hand, the creditors that the debtor-in-possession represents in addition to the Government may not enjoy a superior claim to the seized assets. Even an unperfected security interest has priority over the interest of an unsecured creditor, although there are some exceptions. See Ill. UCC §9-301. As for secured creditors, the Government points out that Pouch's two major lenders had executed agreements subordinating their claims to those of the Government. Appellee's Brief at 5. Thus, it is quite likely that even under my proposed disposition of the case, the Government would ultimately prevail, though certainly a remand would be necessary to determine whether this is correct.

to sue for their proper share of the proceeds, because in destroying the value of their claims, the Government took their property without just compensation. See U.S. Const. amend. V; Armstrong v. United States, 364 U.S. 400 (1960); United States v. Ansonia Brass & Copper Co., 218 U.S. 452, 471 (1910); Marine Midland Bank v. United States, 687 F.2d 395, 397-98 (Ct. Cl. 1982), cert. denied, 460 U.S. 1037 (1983).

I would therefore reverse and remand for further proceedings.

A true Copy:

Teste:

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

IN RE:	)	
	)	
AMERICAN POUCH FOODS, INC.,	)	NO. 80 C 1616
	)	
Debtor.	)	NO. 80 B 14821
	)	
UNITED STATES OF AMERICA,	)	NO. 80 A 2375
	)	
Plaintiff,	)	Honorable Nicholas J. Bua,
v.	)	Presiding
	)	
AMERICAN POUCH FOODS, INC.,	)	
	)	
Defendant.	)	

MEMORANDUM OPINION

On January 29, 1979, American Pouch Foods Company, Inc. ("APF") and the Defense Logistics Agency ("Government") entered into a contract to produce combat rations known as "Meals, Ready to Eat." This product is a replacement for the C-Ration, intended for use principally by the United States Army

and, to a lesser extent, by other branches of the armed services.

Under the terms and conditions of the contract, APF could receive up to 90% of the amount of its total costs incurred under the contract in the form of "progress payments." As one of the terms or conditions for making these progress payments, subsection (d) of the contract provided:

> (d) Title. Immediately, upon the date of this contract, title to all parts; materials, inventories; work in process;...theretofore acquired or produced by the Contractor and allocable or properly chargeable to this contract under sound and generally accepted accounting principles...shall forthwith vest in the Government; and title to all like property thereafter acquired or produced (2) by the Contractor and allocable or properly chargeable to this contract as aforesaid shall forthwith vest in the Government upon said acquisition, production or allocation[1].

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[1] In addition to that already quoted in the text of the opinion, the clause provides:

> Notwithstanding that title to property
> (Footnote Continued)

(3) filed a petition under Chapter 11 of the

(Footnote Continued)
is in the Government through the operation of this clause, the handling and disposition of such property shall be determined by applicable provisions of this contract such as: the Default clause and paragraph (h) of this clause; Termination for Convenience of the Government clause; and the Special Tooling clause. Current production scrap may be sold by the Contractor without approval of the Contracting officer and the proceeds shall be credited against the costs of contract performance. With the consent of the Contracting Officer and on terms approved by him, the Contractor may acquire or dispose of property to which title is vested in the Government pursuant to this clause, and in that event, the costs allocable to the property so transferred from this contract shall be eliminated from the costs of contract performance and the Contractor shall repay to the Government (by cash or credit memorandum) an amount equal to the unliquidated progress payments allocable to the property so transferred. Upon completion of the performance of all the obligations of the Contractor under this contract, including liquidation of all progress payments hereunder, title to all property (or the proceeds thereof) which had not been delivered to, and accepted by the Government under this contract or
(Footnote Continued)

Bankruptcy Code, 11 U.S.C. §101, et seq. At that time APF had in its possession raw materials, work in process, and finished products held at various facilities. The Government claimed all of this property by virtue of the "title vesting" clause of the contract. However, as a result of APF's petition for reorganization, an automatic stay was imposed pursuant to 11 U.S.C. §362 (1976), preventing the Government from obtaining possession of the property.

On December 5, 1980, the Government filed an adversary complaint for relief from

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(Footnote Continued)

which had not been incorporated in supplies delivered to and accepted by the Government under this contract and to which title has vested in the Government under this clause shall vest in the Contractor. The provisions of this contract referring to or defining liability for Government-furnished property shall not apply to property to which the Government shall have acquired titled solely by virtue of the provisions of this clause.

the automatic stay. On January 16, 1981, APF filed an answer and counterclaim. In its counterclaim, APF alleged that the contract termination was unlawful and improper and that as a result of it, APF sustained damages in the aggregate sum of approximately $13 million. Hearings were held, and, on February 9, 1981, the Bankruptcy Court granted the Government relief from the automatic stay and permission to take immediate possession of the property. In its decision, the Court found that as a matter of law, the Government held absolute title to the property by operation of the "title vesting" clause of the contract. The bankruptcy judge did not rule on APF's counterclaim. APF appealed.

On February 1, 1982, this Court concluded that the bankruptcy judge erred in granting relief to the Government because of the existence of two factual questions

regarding: (1) the termination of the contract between the Government and APF, and (2) the characterization of the interest held by the Government in the property to which it claimed title. Accordingly, the cause was remanded to the bankruptcy judge for a full evidentiary hearing on both issues.

The case is now before this Court on the Government's motion for reconsideration. The Government argues that the bankruptcy court properly treated the title issue as a questions of law, and that the case law squarely holds that "title- (4) vesting" clauses, using language substantially identical to that in the contract between the Government and APF, are sufficient to vest absolute title in the Government and allow it to reclaim materials allocable to the contract upon termination for default. The Government also contends that the circumstances concerning the termination of

the contract are irrelevant to the title issue. APF, on the other hand, argues 1) that the title asserted by the Government is a security interest only, 2) that this interest was not perfected in the manner prescribed by applicable state law, and 3) that such title to the extent otherwise valid at all, is subordinate and inferior to the rights of the debtor as debtor-in-possession in this proceeding and to the rights of creditors and other parties in bankruptcy. APF also contends that the Government may not assert title under a contract which it has wrongfully terminated.

For reasons that will be made clear, this Court holds that, as a matter of law, the Government holds absolute title to the property. Additionally, the Court rejects APF's assertion that the Government's title is in any way affected by the allegedly wrongful termination of the contract between

APF and the Government. Finally, the Court declines to address the question, presented in APF's counterclaim, of whether the contract was in fact wrongfully terminated, thus entitling APF to damages. That issue is properly brought before the administrative agency empowered to address such claim.

I. "Title Vesting" Clauses in Progress Payment Provisions

A. The Marine Midland Case

There is a substantial body of case law supporting the Government's position as to title. The fact should make this case one of easy disposition. A recent opinion which seemingly supports APF's argument has complicated the picture, however. That decision is Marine Midland Bank v. United States, 687 F.2d 395 (5) (Ct.Cl 1982). Because that case calls into question some fundamental assumptions implicit in earlier opinions, this Court believes the title issue demands

reexamination. Although ultimately this Court's conclusion is in accord with most of the precedent on this question, it is hoped that the following discussion offers an analytical framework that will eliminate any unnecessary confusion.

Before proceeding to an analysis of prior precedent, some discussion of Marine Midland is in order. In that case, the plaintiff bank brought suit against a government contractor which had agreed to guarantee the indebtedness of a third party. Pursuant to this agreement, the bank secured a floating lien on the contractor's property, including its inventory. Upon the third party's default, the bank sought to obtain possession of the contractor's property. At this point, the Government intervened, claiming that the bank could not take possession of the property because it belonged to the Government in accordance with the

"title vesting" clause contained in its written agreement with the contractor.

The Court in Marine Midland initially focused on the nature of the interest taken by the Government in order to determine whether the Government's possessory right to the property resulted in a compensable taking. After analyzing the enabling legislation and regulations as well as the text of the "title vesting" clause itself, the Court proceeded to distinguish a fairly large and impressive body of precedent, concluding:

> In sum, we hold that the Government's title vesting clause and regulations provide for the taking of an interest in the nature of a lien. Full title, in the plain sense, certainly is not meant, as an examination of the clause and regulations show. We recognize that the Government's use of the word "title" has had an important history, both to avoid the ban on advances of public money and as a way to circumvent floating lien interests of general creditors, and that is has an important present use in insuring that the Government may take actual possession of the inventory of a bankruptcy contractor. (6) There is no other reason, however, in theory or case law to read the word for more than that.

Marine Midland, 687 F.2d at 403-04. The Court then went on to hold that as to the priority of the conflicting security interests between the Government and the bank, the rule of decision "is to make the Government's security interest under its title vesting procedures paramount to the liens of general creditors." Id. at 404.

Although the Government "won" the Marine Midland case, in that it was found to have a paramount lien interest, it is possible that if the Court's reasoning were applied to the instant case,the result would be different, requiring a judgment for APF. This is because of a case relied on by APF entitled United States v. Lennox Metal Mfg. Co., 225 F.2d 302 (2d Cir. 1955). In that case, the Court apparently assumed that the interest held by the Government, on the peculiar facts of the dispute, was in the nature of an equitable lien. Id. at 317 (opinion of

Medina, J., and Hincks, J.). After so finding, the Court then went on to hold that this lien could not be asserted by the Government because of its inequitable conduct in its relationship with Lennox. Thus, if the Government in this case possesses a lien interest, and if it wrongfully terminated its conduct with APF, it might be foreclosed from asserting its interest under the contract by a combined reading of Lennox and Marine Midland. It is for this reason that this Court must determine whether Marine Midland was in fact correctly reasoned. As has already been stated, the Court has concluded that it was not[2].

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[2]This entire discussion, of course, assumes that Lennox, in addition to Marine Midland was correctly decided. That assumption is very much in doubt. See Pasley, The Interpretation of Government Contracts: A Plea For Better Understanding, 25 Fordham L. Rev. 211, 236-37 (1956); Whalen,

(Footnote Continued)

B. Statutory and Regulatory Framework

(7) It is impossible to explain the nature of the interest established by the "title vesting" clause of the Government's contract with APF without first providing some background. The "title vesting" clause is simply one element of a scheme of federal procurement based on "progress payments." Such payments are unique, and it is this uniqueness which gives rise to the peculiar rights possessed by the Government in this case. As a preliminary matter, it is essential to identify the distinctions between "progress payments" and "advance payments," (two terms of art in this area of law) before the Government's interest may be defined properly. It is to those

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(Footnote Continued)
Government Supply Contracts: Progress Payments Based on Costs; The New Defense Regulations, 26 Fordham L. Rev. 224, 230 (1957).

distinctions, found in the enabling legislation, regulations, and administrative practices, to which the Court now turns.

The starting point for this discussion is the definitions of these two types of payments. Those definitions are contained in the applicable regulations. Both terms contemplate payment in advance of full completion of a contract. "Progress payments," however, are payments made as work progresses, and are determined on the basis of costs incurred, percentage of work completed, or the stage reached in a particular project. 32 C.F.R. §163.11 (1982). "Progress payments" thus presume some performance under the contract, even though they are made prior to acceptance by and delivery to the Government of the finished product. "Advance payments," while also made well before acceptance and delivery, do not require any performance, but rather are made "prior to,

in anticipation of, and for the purpose of complete performance under a contract or contracts."

32 C.F.R. §163.9 (1982).

As can be seen by these descriptions, "advance payments" operate on the order of a loan, while "progress payments" are more in the nature of purchases. As was noted over a quarter of a century ago:

> It has been long recognized and understood that an "advance payment" is a loan by the Government and can (8) be made "only upon adequate security"...but "partial payments" [3] ["progress payments"] are payments made by the Government in purchase of materials and are authorized when ownership thereto vests in the Government.

City of Detroit v. Murray Corp., 355 U.S. 489, 517-18, n.4 (1958) (Whittaker, J., dissenting).

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[3] In the past, the term "partial payments" has been used to describe what are now consistently called "progress payments."

(Footnote Continued)

This fundamental, historical difference between "progress payments" and "advance payments" is easily discerned in the enabling legislation[4]. The relevant statutory

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(Footnote Continued)
Whalen, Government Supply Contracts: Progress Payments Based on Costs; The New Defense Regulations, 26 Fordham L. Rev. 224, 230, n. 25 (1957).

[4]10 U.S.C. §2307 (1976) provides:

"§2307. Advance payments.
(a) The head of any agency may:
(1) Make advance, partial, progress, or other payments under contracts for property or services made by the agency; and (2) Insert in bid solicitations for procurement of property or services a provision limiting to small business concerns advance or progress payments.
(b) Payments made under subsection (a) may not exceed the unpaid contract price.
(c) Advance payments made under subsection (a) may be made only if the contractor gives adequate security and after a determination by the head of the agency that to do so would be in the public interest. Such security may be in the form of a lien in favor of the United States on the property contracted for, on the balance in an account in which such payments are deposited, and on such of the property acquired for performance of the contract as the parties may agree. This lien
(Footnote Continued)

provision, 10 U.S.C. §2307(a)(1), provides that the head

of any agency is authorized to make "advance," "partial," "progress," or "other" payments. But whereas subsections (b) and (d) refer to "[p]ayments made under subsection (a)" (9) (that is, all payments), subsection (c) singles out "advance payments made under subsection (a)," and requires that such payments have "adequate security" which may be in the form of a "lien," "paramount to any other liens."

Further evidence of the distinction between "progress payments" and "advance

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(Footnote Continued)
is paramount to any other liens.
(d) Payments under subsection (a) in the case of any contract, other than partial, progress, or other payments..."

payments" can be found in the applicable regulations[5].

32 C.F.R. Part 163 implements the authorization to make "advance payments" and "progress payments" under 10 U.S.C. §2307 (1976). Subpart D pertains to "Advance Payments" and provides information on "Interest" (§163.53) and "Security" (§163.63). "Advance payment provisions" are set out in §163.64-2 and include contract clauses for "Interest charge" (163.64-2(f)), "Lien on special bank account" (§163.64-2(h)), and "Lien on property under

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[5]Interpretive regulations by officers, departmental heads, and others charged with the duty of administering a statute, as well as those persons' practices which reflect their understanding of provisions they are required to carry out, have great weight in determining the operation of a statute. Norwegian Nitrogen Products Co. v. United States, 288 U.S. 294 (1933); United States v. Clark, 454 U.S. 555, 561-62 (1982); See generally Sutherland, Stat. Const. §49.05 (4th Ed.).

contract" (§163.64-2(i)). In contrast, Subpart E pertains to "Progress Payments Based on Costs," but contains no information on liens or security. Section 163.79-2 sets forth the "Progress Payment clause for small business concerns," which is identical to that contained in the Government's contract with APF. Section 163-79-2(d) is the "title vesting" clause.

The different treatment accorded to "advance payments" and "progress payments" in the current statute and regulations is not accidental, but rather is a result of historical development. That development has a crucial impact on this lawsuit, in that one of its consequences has been that "title vesting" and government ownership have become associated with "progress payments," while "liens" have become associated with "advance payments." That historical development is

thus (10) the next topic to which the Court's attention must be directed.

C. Historical Development

Prior to 1958, when Congress amended 10 U.S.C. §2307 to include "partial," "progress," and "other" payments, some commentators[6] believed that the practice of making "progress payments" was prohibited by Rev. Stat. 3648 (1873) as amended, 31 U.S.C. §3324 (1982)[7]. In part, it was this supposed

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[6]McClelland, The Illegality of Progress Payments as a Means of Financing Government Contractors, 33 Notre Dame Law. 380 (1958).

[7]Rev. Stat. §3648 (1873), as amended, 31 U.S.C. §3324 (1982) provides:

§3324. Advances

(a) Except as provided in this section, a payment under a contract to provide a service or deliver an article for the United States Government may not be more than the value of the service already provided or the article already delivered.

(b) An advance of public money may be made only if it is authorized by

(1) a specific appropriation or

(Footnote Continued)

prohibition which caused the Court in Marine Midland to reject wholesale the preceding line of cases which interpreted "title vesting" clauses as creating absolute title. The Court reasoned that the

> government's use of the word 'title' has had an important history, [and in part has been inspired by the desire to]...-avoid the ban on advances of public money...

Marine Midland, 687 F.2d at 403-404 (emphasis added). Thus, the Court asserted, cases interpreting the word "title" must be recognized as coming from a legal setting in which it was necessary to characterize title vesting fairly literally in order to preserve the legality of the government's practice of making progress payments...

(Footnote Continued)
other law, or...

See also McClelland, footnote 6, supra.

(11) Id. at 400. This Court's independent analysis of the historical underpinnings of the earlier cases leads it to a different conclusion than that reached by the Marine Midland Court, however.

As early as 1885, the United States Attorney General held that while Rev. Stat. 3648 (1873) as amended, 31 U.S.C. §3324 (1982), see n.7, supra., on its face was prohibitory (as it still is), it was not intended to bar payments for work in progress when the amount of the payment had been earned by the contractor. This administrative interpretation, which became known as the "equivalent benefit theory," 18 Op. Atty. Gen. 105 (1885), was subsequently accepted by accounting officers of the Government, 17 Comp. Dec. 894 (1911); 1 Comp. Gen. 143 (1921).

By 1941, the "equivalent benefit theory" had fully matured into its modern form,

aligning "title vesting" with "progress payments" and liens with "advance payments." As the Comptroller General stated in that year,

> While, under prohibition of the Statute [Rev. Stat. §3648 (1873), as amended, 31 U.S.C. §3324 (1982)], articles in which the United States has acquired no right or interest and from which it derives no benefit, payment may be made for articles in advance of their actual possession of the United States if title therein has vested in the Government at the time of such payment [as with progress payments], or if articles are impressed with a valid lien in favor of the United States in an amount at least equal to the payment [as with advance payments].

20 Comptr. Gen. 917 at 918 (1941) quoted in Bachman, Defense Department Contract Financing, 25 Geo. Wash. L. Rev. 228, 229, n.3 (1957). This alignment was so fully a part of administrative practice, that in 1958, when 10 U.S.C. §2307 was amended to include progress payments, some questioned why such an amendment (12) was even

necessary[8]. Ultimately, the two types of payments with their unique attributes resulted in the two distinct forms of federal procurement found in the current statute and regulations. The distinction, although often not addressed specifically, certainly must have influenced case law interpreting "title vesting" clauses in federal procurement contracts. In fact, it is this Court's belief that the relevant case law cannot be understood without this background, because the historical developments form the

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[8]In reviewing the proposed 1958 amendment to 10 U.S.C. §2307, Robert Dechert, General Counsel of the Department of Defense, commented:

"[T]his Department has long considered that it had adequate authority in law to make...progress payments under appropriate contractual agreements..." Senate Comm. on Government Operations, Small Business Concerns -- Opportunities to Obtain Government Purchases and Contracts, S. Rep. No. 2201, 85th Cong., 2d Sess., reprinted in 1958 U.S. Code Cong. & Ad. News 4021, 4032.

fundamental, albeit unstated, assumptions on which the opinions are based. Because the courts can be assumed to have accepted the almost universally-held belief that progress payments were legal, it is reasonable to believe that, contrary to Marine Midland's view, those courts did not interpret "title vesting" clauses merely with the goal of "preserving the legality" of the Government's procurement practices, see p. 10, supra. Rather, this Court believes that the legality of such payments was simply, and properly, taken for granted, allowing the Courts to proceed to the straight-forward task of contract interpretation. That interpretation is discussed below.

C. Case Law

"Title vesting" clauses have reached the Supreme Court on more than one occasion. In the leading case interpreting such clauses, the Supreme Court stated:

> (13) [I]t is...well settled that if the contract is such to clearly express the intention of the parties that the builder shall sell and the purchaser shall buy the ship before its completion, and at the different stages of its progress, and this purpose is expressed in the words of the contract, it is binding and effectual to pass the title. [Citations omitted.] All sections of the agreement must be read in the light of the purposes of the contracting parties as gathered from the entire contracts, and must be considered in connection with other provisions of the contract.

United States v. Ansonia Brass & Copper Co., 218 U.S. 452, 457 (1910). The Court then considered the provisions of the contract that the defendant contended were inconsistent with ownership, namely, 1) the requirement that the contractor insure the property and 2) the fact that the Government maintained the right to reject the final product. In conclusion, the Court stated:

> Construing the whole contract, we find nothing in its other provisions which cuts down or lessens the binding force of the clear and distinct provisions...as to ownership. The parties therein dealt with a specific part of the contract, they expressed themselves

> clearly upon the subject, and it is not to be presumed, in the absence of clear expression or necessary implication, that they intended to supersede this provision in dealing with other specific and general parts of the agreement.

Ansonia, 218 U.S. at 469.

In United States v. County of Allegheny, 322. U.S. 174 (1944), a tax case, the Supreme Court again confronted a "title vesting" clause. There, the contract provided that the Government acquired machinery through Mesta (the contractor) upon inspection and acceptance -- events which actually took place. The Supreme Court held that title (ownership) vested in the Government.

More recently, in City of Detroit v. Murray Corp., 355 U.S. 489 (1958), the Supreme Court dealt with the taxation of personal property acquired by Murray Corporation pursuant to contract provisions almost identical to those presently before this Court, see n.1, supra. Specifically, the "title vesting" clause provided (14) that in

return for "progress payments," title to certain parts, materials, and other contract properties, when acquired by the contractor, would vest in the Government. Additionally, the clause provided that (1) title to certain property vested in the Government both before and after payment was made; (2) the contractor retained possession; (3) the contractor would have to replace qualitatively defective "title vested" property at its own expense; (4) the contractor bore the risk of loss; (5) "left-over" items revested in the contractor; (6) the custodial regulations usually applicable to the handling of Government property in the possession of contractors were not applicable to "progress payment" property; and (7) the Government was not primarily interested in acquiring the "progress payment" property as such, but rather in acquiring the contract end item which was to

be manufactured, processed, fabricated, etc., out of the "progress payment" property. Id. at 514-16 (Whittaker, J., dissenting). All of the above conditions are contained in the contract entered into in this case between the Government and American Pouch Foods.

The majority of the Court assumed without deciding that the Government had title to the "progress payment" property. Id. at 492, n.2. On the other hand, Justice Whittaker, joined by Justices Frankfurter, Burton, and Harlan, faced the title issue squarely. After thoroughly analyzing the apparently inconsistent contract provisions, Id. at 519-24, Justice Whittaker concluded: "I believe that...the contracts in question conveyed full beneficial title -- all elements of title and incidents of ownership -- in the materials to the Government." Id. at 524. With respect to Ansonia Brass, Justice Whittaker noted: "This Court...held that the

contract -- containing title vesting provisions almost identical with the ones here -- conveyed full ownership of the unfinished vessel -- not a mere lien -- to the Government. The principles of that decision appear to have been followed in every decided case in this country save one." Murray, 355 U.S. at 523-24. (Citations (15) omitted.)[9]

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[9]The case referred to by Justice Whittaker (which provided the last occasion on which the Supreme Court confronted the "title vesting" clause) is American Motors Corp. v. City of Kenosha, 274 Wis. 315, 80 N.W.2d 363 (1957), aff'd, 356 U.S. 21 (1958) (per curiam). But see, contra, State ex rel. Superior Shipbuilding Company v. Buckley, 175 Wis. 272, 185 N.W. 199 (1957); See also Whelan, Government Contract Privileges: A Fertile Ground for State Taxation, 44 Va. L. Rev. 1099, 1109-10, n.54 (1958). In American Motors, the Wisconsin Supreme Court held that "title" was a matter for federal law not state law, but "ownership" was to be determined by the state. Because the United States Supreme Court affirmed the decision per curiam without opinion, we are left to speculate as to the rationale of the majority.

Since Ansonia, lower courts have confronted "title vesting" clauses on several occasions. See generally, In re Murdock Machine & Eng. Co. of Utah, 620 F.2d 767 (10th Cir. 1980); United States v. Digital Products Corp., 624 F.2d 690 (5th Cir. 1980); In re Double H Products, 462 F.2d 52 (3d Cir. 1972); Shepard Engineering Co. v. United States, 287 F.2d 737 (8th Cir. 1961); In re American Boiler Works, 220 F.2d 319 (3rd Cir. 1955); United States v. Lennox Metal Manufacturing Co., 225 F.2d 302 (2d Cir. 1955); In re Greenstreet, Inc., 209 F.2d 660 (7th Cir. 1954); In re Read-York, 152 F.2d 313 (7th Cir. 1945); United States v. Matadure Corporation, CV 80-0460, slip op. (E.D.N.Y. April 17, 1980); United States v. Buder, 414 F.Supp. 1 (E.D. Mo. 1975) affirmed 588 F.2d 333 (8th Cir. 1976); United States v. Ameco Electronic Corporation, 224 F.Supp. 783 (E.D.N.Y. 1963); Marine Midland Bank v.

United States, 687 F.2d 395 (Ct.Cl. 1982); Boeing Co. v. United States, 168 Ct.Cl. 109, 338 F.2d 342 (1964), cert. den. 380 U.S. 972 (1965). As has already been stated, of those cases, only two have considered the "title vesting" clause as creating a lien interest in the Government, see pps. 4-6, supra.

For the reasons already set forth, the Court has decided to follow the clear consensus of the precedent. As the Third Circuit explained:

> (16) Contentions such as these [that the "title vesting" clause creates a lien] have frequently been advanced over the years in attempts to escape the effect of the title-passing provisions of fixed-price Government contract partial [progress] payment clauses. "At least to the extent of the partial [progress] payments, the courts have, in a variety of situations, almost unanimously sustained the provision as effecting a full and complete passage of title or ownership, and as not creating only a lien or security interest." Boeing Company v. United States, 338 F.2d 342, 345 (1964), cert. denied, 380 U.S. 972 (1965).

In re Double H Products Corporation, 462 F.2d 52, 55 (3d Cir. 1972) see also In re Read-York, 152 F.2d 313, 316 (7th Cir. 1945).

One final note is in order. As part of its argument, APF claims that as a debtor-in-possession, it is vested with all the powers and authority of a creditor, without notice, who obtained a judicial lien on the date of bankruptcy, regardless of whether such creditor exists. 11 U.S.C. 544(a) (1976). As such, APF claims that its interest is clearly and unequivocally paramount to that of any unperfected security interest such as that asserted by the Government.

Because the Court has already concluded that as a matter of law the Government holds absolute title to the property, APF's argument fails. But even if it could be said that the Government simply took a lien in the described inventory to secure its progress payments, in light of 10 U.S.C. 2307(c)

(1976), see n.4, supra, the Government's lien would be paramount. Moreover, that lien would be paramount without regard to the perfection requirements of state law[10]. United States v. (17) County of Allegheny, 322 U.S. 174 (1944); Clearfield Trust Co. v. United States, 318 U.S. 363 (1943); In re Read-York, 152 F.2d 313 (7th Cir. 1945). Finally, because such a lien would in effect be created by contract, it would not be a statutory lien subject to avoidance under 11

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[10] United States v. Kimbell Foods, Inc., 440, U.S. 715 (1979) does not change this pronouncement. In Kimbell, the Court declared that the question of priorities is one of federal law, but chose as its rule of decision state enactments of Article 9. Kimbell specifically left open, however, the ability of the courts to fashion uniform rules in cases that required it, 440 U.S. at 740. With respect to federal procurement, resort to state laws would be "contrary to evident congressional intent and established federal practice." Marine Midland Bank v. United States, 687 F.2d 395, 404 (Ct.Cl. 1982).

U.S.C. 544(a) (1976). Lawrence v. United States, 378 F.2d 452 (5th Cir. 1967).

For all the foregoing reasons, this Court holds that the Government possesses full, absolute title in the property covered by the title vesting clauses.

II. APF's Counterclaim for Wrongful Termination

As has already been stated, on December 5, 1980, the Government filed an adversary complaint in the Bankruptcy Court. The complaint was designated as a complaint for relief from automatic stay. On January 16, 1981, APF filed an answer and counterclaim. In its counterclaim, APF alleged that the Government's termination of its contract with APF was unlawful and improper because 1) APF's delay was excusable, 2) the standards applied by the government to APF were arbitrary, and 3) the termination denied APF its right to due process under the Fifth

Amendment. APF further alleged that because of the Government's unlawful and improper termination, it sustained damages in the aggregate sum of $13,250,000.

On February 17, 1983, the reference to the Bankruptcy Court was withdrawn and the action was transferred to this Court for adjudication. The Government now moves in this Court for dismissal of the counterclaim. The Government claims two grounds for dismissal: 1) the Contract Disputes Act of 1978 precludes this Court's jurisdiction, and 2) the counterclaim is barred by the doctrine of sovereign immunity. Alternatively, the Government asks that even if this Court finds that it has the power to reach the merits of the counterclaim, it should, in its discretion, abstain from exercising that power pursuant to 28 U.S.C. §1471(d) (Supp. II 1978). The Court believes the latter approach is the (18) appropriate one, and has

decided to abstain. In so doing, no view is expressed on the merits of the Government's assertion of sovereign immunity. On the other hand, since the Contract Disputes Act of 1978 did not become effective until March 1, 1979, and since the contract between the Government and APF was entered into on January 29, 1979, the Government's arguments concerning the applicability of that Act to this case are specifically rejected. Contract Disputes Act of 1978, effective March, 1, 1979, Pub. L. No. 95-563, 92 Stat. 2383 (1978), 41 U.S.C. §601-613 (Supp. II 1978). See also Tuttle/White Contractors, Inc. v. United States, 656 F.2d 644, 646 (Ct.Cl. 1981).

With respect to its decision to abstain, the Court notes that its jurisdiction over the counterclaim is predicated on 28 U.S.C. §1471 (Supp. II 1978). Subsection (b) empowers this Court with "original but not

exclusive jurisdiction of all civil proceedings arising under Title 11." Subsection 147(d) provides:

> Subsection (b)...of this Section does not prevent a district court...in the interest of justice, from abstaining from hearing a particular proceeding arising under Title 11 or arising in or related to a case under Title 11. Such abstention, or a decision not to abstain is not reviewable by appeal or otherwise.

APF's counterclaims, although arising out of a petition for reorganization under Title 11, are, nevertheless, in essence, Government contract disputes. Because such disputes involve a very specialized area of the law, institutions such as the Armed Services Board of Contract Appeals and the Court of Claims have been created and specifically designed to resolve them. See, Matter of Gary Aircraft Corp., 698 F.2d 775, 784 (5th Cir. 1983). (ASBCA provides expertise, uniformity and speed in resolving Government contract disputes); In re Verco Industries,

SA 80-0845 (Bankr. C.D. Cal. August 24, 1981), slip op. at 3. (Court of Claims provides expertise resulting from history of exclusive jurisdiction in Government contract disputes).

(19) The Court, therefore, in the interest of justice, abstains from hearing APF's counterclaim, and APF is directed to reassert its claim before either the Board of Contract Appeals or the Court of Claims.

IT IS SO ORDERED.

_____

Nicholas J. Bua
Judge, U.S. District Court

Dated: June 20, 1983

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

IN RE:	)	
	)	
AMERICAN POUCH FOOD COMPANY, INC.,	)	
	)	
Debtor.	)	NO. 80 B 14821
	)	
	)	
UNITED STATES OF AMERICA,	)	
	)	
	)	
Plaintiff,	)	NO. 81 C 1616
	)	NO. 81 C 2914
vs.	)	NO. 80 A 2375
	)	
AMERICAN POUCH FOOD COMPANY, INC.,	)	
	)	
	)	
Defendant.	)	

O R D E R

In light of the existence of factual questions with regard to (1) the termination of the contract between the government and American Pouch Foods Company and (2) the appropriate characterization of the interest held by the government in the property to which the government now claims title, it is

this court's conclusion that the grant of summary judgment in favor of the government by the bankruptcy judge was inappropriate.

Therefore, this cause is remanded for a full hearing on the aforementioned issues.

Dated January 29, 1982

Honorable Nicholas J. Bua
U.S. District Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

IN RE:	)	
	)	
AMERICAN POUCH FOOD COMPANY, INC.,	)	
	)	
	)	
Debtor.	)	No. 80 B 14821
	)	
UNITED STATES OF AMERICA,	)	
	)	
Plaintiff,	)	
	)	
vs.	)	No. 80 A 2375
	)	
AMERICAN POUCH FOOD COMPANY, INC.,	)	
	)	
Defendant.	)	

O R D E R

The court held a trial on the complaint of the United States, plaintiff, against American Pouch Foods Co., Inc., defendant, for relief from automatic stay. For the reasons stated in open court on February 9, 1981, the court finds and concludes that the United States has title to the property in the possession of American Pouch at its

facilities or being held in American Pouch's name at certain warehouses. It is therefore order that judgment is entered in favor of the United States on Counts I and II of its complaint and against American Pouch Foods Co., Inc., and the other defendants and that the United States take possession of the property of American Pouch at its facilities or being held in its name at the Dry Storage Warehouse or at Producer's Terminal Warehouse.

DATED: February 6, 1981

Honorable Thomas James
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

IN RE:	)	
	)	
AMERICAN POUCH FOOD COMPANY, INC.,	)	
	)	NO. 80 B 14821
	)	
Debtor.	)	
	)	
UNITED STATES OF AMERICA,	)	
	)	
Plaintiff,	)	
	)	
vs.	)	Adversary No. 80 A 2375
	)	
AMERICAN POUCH FOOD COMPANY, INC.,	)	
	)	
	)	
Defendant.	)	

MEMORANDUM AND ORDER

United States, plaintiff, has moved for the entry of judgment on count III of its complaint against American Pouch Food Company, Inc., debtor. The motion of the United States will be granted and judgment entered in favor of the United States and against American Pouch on count III.

The court entered judgment in favor of the United States on counts I and II of the complaint on February 9, 1981. Count I asked for return of property in American Pouch's possession the government had provided. Count II covered property not provided by the government. Count III concerns property in the possession of Oregon Freeze Dry Foods, Inc.

The government and Oregon Freeze Dry have settled their dispute concerning title to the goods in count III. By the present motion the government seeks to have its right to these goods declared superior to any right American Pouch may have in the property.

For the reasons stated in open court on February 9, 1981 the court concluded that the United States had title to the goods involved in counts I and II. For the same reasons the United States has rights superior to those of American Pouch in goods acquired by American

Pouch that are in the possession of Oregon Freeze Dry.

It is therefore ordered that the motion of the plaintiff for entry of judgment on count III is granted. Judgment is entered on count III in favor of the United States, plaintiff, and against American Pouch Food Company, Inc., debtor-defendant.

Dated March 27, 1981

Honorable Thomas James
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

IN RE:	)	
	)	
AMERICAN POUCH FOOD COMPANY, INC.,	)	
	)	NO. 80 B 14821
	)	
Debtor.	)	
	)	
UNITED STATES OF AMERICA,	)	
	)	
Plaintiff,	)	
	)	
vs.	)	Adversary No. 80 A 2375
	)	
AMERICAN POUCH FOOD COMPANY, INC.,	)	
	)	
	)	
Defendant.	)	

MEMORANDUM AND ORDER

United States, plaintiff, has moved to dismiss the counterclaim of American Pouch Food Company, Inc., debtor, on the grounds that the court lacks jurisdiction over Pouch's counterclaim because it concerns the termination of Pouch's contract with the Defense Logistics Agency, that Pouch must

bring its complaint to the Armed Services Board of Contract Appeals or the Court of Claims as provided in the contract, that ASBCA and the Court of Claims have exclusive jurisdiction of questions concerning such government contracts, and that the expanded jurisdiction of the bankruptcy court was not intended to embrace a debtor's claim arising out of a government contract. United States also moves for lifting of the automatic stay so that it may issue a final decision confirming termination of Pouch's contract and in support of this motion asserts that a final decision must be issued for Pouch to pursue any relief. This motion is made on the assumption that Pouch must seek relief outside the bankruptcy court. The motions will be denied.

This court does have jurisdiction over Pouch's counterclaim. 28 U.S.C. 1471 provides that bankruptcy courts have

jurisdiction of all civil proceedings arising under Title 11 of the United States Code. Pouch's claim against the government is property of the estate. It is related to Pouch's bankruptcy case and is within the jurisdiction of the court. The motion to dismiss should be denied.

The government wants the stay lifted so that it can issue a final decision of termination of Pouch's contract, after which Pouch would be able to file a claim with the ASBCA or the Court of Claims within a specified period of time. Pouch had indicated by its counterclaim and opposition to these motions that it intends to pursue its claim in this proceeding and not in the manner urged by the government. Because this court has jurisdiction over the counterclaim the disposition of which will dispose of all matters between these parties there is no need to lift the stay. The court is also

mindful of the argument that could be made if the court were to lift the stay and permit the termination notice that this court recognizes that it does not have jurisdiction of Pouch's counterclaim. The court does have jurisdiction and has asserted that jurisdiction. There is no reason for the parties to resolve their problems in any other forum, but here.

It is therefore ordered that the motions of the United States, plaintiff, counter-defendant, to dismiss the counterclaim of American Pouch Foods Company, Inc., defendant-counterclaimant, and to obtain relief from the automatic stay are denied and that the counter-defendant serve an answer to the counterclaim on or before June 22, 1981.

Dated June 5, 1981

Honorable Thomas James
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

IN RE:	)	
	)	
AMERICAN POUCH FOOD COMPANY, INC.,	)	
	)	NO. 80 B 14821
	)	
Debtor.	)	
	)	
UNITED STATES OF AMERICA,	)	
	)	
Plaintiff,	)	
	)	
vs.	)	Adversary No. 80 A 2375
	)	
AMERICAN POUCH FOOD COMPANY, INC., INC.,	)	
	)	
Defendant.	)	

MEMORANDUM AND ORDER

Counterdefendant United States of America has moved for reconsideration of the court's order of June 15, 1981 concluding that this court has jurisdiction over the counterclaim of American Pouch Food Company, Inc., debtor, counterplaintiff. The motion will be denied.

The United States again questions the subject matter jurisdiction of this court, this time on the ground that the United States has not waived its sovereign immunity in this court. Only Congress may waive sovereign immunity. If it has not done so by §106(a) of the Bankruptcy Code this court does not have jurisdiction over Pouch's counterclaim. The court concludes that Congress has waived the claimed sovereign immunity.

Section 106(a) of the Bankruptcy Code provides that a governmental unit is deemed to have waived sovereign immunity with respect to any claim against such governmental unit that is property of the estate and that arose out of the same transaction or occurrence our of which such governmental unit's claim arises. Claim is defined in §101(4) as meaning:

> (A) right to payment, whether or not such right is reduced to judgment,

liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured... .

This is the definition that the court must use to interpret §106(a). The legislative history of this section, found in part 3 of the 1981 Collier Pamphlet Edition of the Bankruptcy Code, states:

Paragraph (4) defined "claim." The effect of the definition is a significant departure from present law. Under present law, "claim" is not defined in straight bankruptcy. Instead it is simply used, along with the concept of provability in section 63 of the Bankruptcy Act, to limit the kinds of obligations that are payable to a bankruptcy case. The term is defined in the debtor rehabilitation chapters of present law far more broadly. The definition in paragraph (4) adopts an even broader definition of claim that is found in the present debtor rehabilitation chapters. The definition is any right to payment, whether or not reduced to judgment, liquidated, unliquidated,

fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured. The definition also includes as a claim an equitable right to performance that does not give rise to a right to payment. By this broadest possible definition, and by the use of the term throughout the title 11, especially in subchapter I of chapter 5, the bill contemplates that all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case. It permits the broadest possible relief in the bankruptcy court.

[House Report No. 95-595, 95th Cong., 1st Sess. (1977) 309; Senate Report No. 95-989, 95th Cong., 2d Sess. (1978) 21.]

Section 101(4)(B) represents a modification of the House-passed bill to include the definition of "claim" a right to an equitable remedy for breach of performance if such breach gives rise to a right to payment. This is intended to cause the liquidation or estimation of contingent rights of payment for which there may be an alternative equitable remedy with the result that the equitable remedy will be susceptible to being discharged in bankruptcy. For example, in some States, a judgment for specific performance may be satisfied by an alternative right to payment, in the event performance is refused; in that event, the creditor entitled to specific performance would have a "claim" for purpose of a proceeding under title 11.

On the other hand, rights to an equitable remedy for a breach of performance

> with respect to which such breach does not give rise to a right to payment are not "claims" and would therefore not be susceptible to discharge in bankruptcy.
>
> [124 Cong. Rec. H11,090 (Sept. 28, 1978) S. 17,406 (Oct. 6, 1978).]

If the cause of action set forth in the complaint included not only an equitable remedy for breach of Pouch's contract with the Defense Personnel Support Center, but also a right to payment for the breach, whether or not brought, it is a claim under §101(4). Paragraph VII of first count of the complaint alleged that it was urgent that the Support Center by given possession of the products listed in the complaint, all of which were government owned property so that the government might have adequate protection and mitigate its claim for damages under the breach of Pouch's contract, as required by law. The cause of action is one for breach of contract and a claim within the meaning of 101(4), either return the goods or pay for

them, and thus a claim within the meaning of §106(a). The United States has waived its sovereign immunity in regard to Pouch's counterclaim for the counterclaim is property of the estate and arises out of the alleged termination of the contract, the same transaction out of which the claim of the Support Center arises.

The court is not persuaded by the argument that it does not have jurisdiction because of the Contract Disputes Act, 41 U.S.C. §§601 et seq. as was noted in its memorandum and order of June 5, 1981. Congress established the bankruptcy court as a specialized court to insure the orderly and equitable administration, collection and distribution of debtors' estate whether under chapter 7, chapter 9, chapter 11 or chapter 13. It gave the bankruptcy courts' pervasive jurisdiction so that this court could handle

cases expeditiously with maximum economy to the estates.

It is therefore ordered that the motion of the United States of America, plaintiff, for reconsideration of the court's order of June 15, 1981, is denied.

Dated May 14, 1982

Honorable Thomas James
U.S. Bankruptcy Judge

JUDGMENT -- ORAL ARGUMENT

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

CHICAGO, ILLINOIS 60604

JULY 30, 1985

Before

Honorable JOEL M. FLAUM,
Circuit Judge
Honorable LUTHER M. SWYGERT,
Senior Circuit Judge*
Honorable THOMAS E. FAIRCHILD,
Senior Circuit Judge

No. 83-2530

IN THE MATTER OF: AMERICAN POUCH FOODS COMPANY, INC.,	) Appeal from the United States District Court for the Northern District of Illinois, Eastern Division Nos. 81-C-1616 and 81-C-2914 Judge NICHOLAS J. BUA,
Debtor-Appellant.	

This cause was heard on the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, IT IS ORDERED AND ADJUDGED by this Court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, AFFIRMED, with costs, in accordance with the opinion of this Court filed this date.

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

CHICAGO, ILLINOIS 60604

SEPTEMBER 24, 1985

Before

Honorable JOEL M. FLAUM,
Circuit Judge
Honorable LUTHER M. SWYGERT,
Senior Circuit Judge*
Honorable THOMAS E. FAIRCHILD,
Senior Circuit Judge

IN THE MATTER OF: AMERICAN POUCH FOODS COMPANY, INC., No. 83-2530 Debtor-Appellant.	) Appeal from the United States District Court for the Northern District of Illinois, Eastern Division Nos. 81-C-1616 and 81-C-2914 NICHOLAS J. BUA, Judge.

O R D E R

On consideration of the above-entitled petition for rehearing and suggestion for rehearing in banc, filed by counsel for the debtor-appellant, a majority* of the original panel having voted to DENY petition, and no

judge in regular active service having requested a vote on the in banc suggestion,

IT IS HEREBY ORDERED, that the petition for rehearing and suggestion for rehearing in banc be, and the same is DENIED.

*Senior Circuit Judge Luther M. Swygert voted to grant rehearing.

10 U.S.C. §2307. Advance Payments

(a) The head of any agency may--
(1) make advance, partial, progress, or other payments under contracts for property or services made by the agency; and
(2) insert in bid solicitations for procurement of property or services a provision limiting to small business concerns advance or progress payments.

(b) Payments made under subsection (a) may not exceed the unpaid contract price.

(c) Advance payments made under subsection (a) may be made only if the contractor gives adequate security and after a determination by the head of the agency that to do so would be in the public interest. Such security may be in the form of a lien in favor of the United States on the property contracted for, on the balance in an account in which such payments are deposited, and on such property acquired for performance of the contract as the parties may agree. This lien is paramount to any other liens.

(d) Payments under subsection (a) in the case of any contract, other than partial, progress, or other payments specifically provided for in such contract at the time such contract was initially entered into, may not exceed $25,000,000 unless the Committees on Armed Services of the Senate and the House of Representatives have been notified in writing of such proposed payments and 60 days of continuous session of Congress have expired following the date on which such notice was transmitted to such Committees and neither House of Congress has adopted, within such 60-day period, a resolution disapproving such payments. For purposes of this section, the continuity of a session of Congress is broken only by an adjournment of the Congress

sine die, and the days on which either House is not in session because of an adjournment of more than 3 days to a day certain are excluded in the computation of such 60-day period.

§544. Trustee as lien creditor and as successor to certain creditors and purchasers.

(a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by--

(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract would have obtained a judicial lien, whether or not such a creditor exists;

(2) a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists; and

(3) a bona fide purchaser of real property from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser at the time of the commencement of the case, whether or not such a purchaser exists.

§1107. Rights, powers, and duties of debtor in possession.

(a) Subject to any limitations on a trustee serving in a case under this chapter, and to such limitations or conditions as the court precribes, a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all the functions and duties, except the duties specified in sections 1106(a)(2), (3), and (4) of this title, of a trustee serving in a case under this chapter.

§9-301. Persons Who Take Priority Over Unperfected Security Interests--Rights of "Lien Creditor".

(1) Except as otherwise provided in subsection (2), an unperfected security interest in subordinate to the rights of. . .

(b) a person who becomes a lien creditor before the security interest is perfected; . . .

(3) A "lien creditor" means a creditor who has acquired a lien on the property involved by attachment, levy or the like and includes an assignee for benefit of creditors from the time of assignment, and a trustee in bankruptcy from the date of the filing of the petition or a receiver in equity from the time of appointment. . . .

Supreme Court, U.S.
FILED
FEB 24 1986
JOSEPH F. SPANIOL, JR.
CLERK

(2)

No. 85-1079

In the Supreme Court of the United States

OCTOBER TERM, 1985

AMERICAN POUCH FOOD CO., INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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Assistant Attorney General

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15 pp

QUESTION PRESENTED

Whether a Department of Defense procurement contract providing that "title to all * * * [property] * * * acquired or produced by the [c]ontractor and allocable or properly chargeable to this [c]ontract * * * shall forthwith vest in the Government" passes title to the government in such property, thereby removing the property from competing claims in the event of the contractor's bankruptcy.

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In the Supreme Court of the United States

OCTOBER TERM, 1985

No. 85-1079

AMERICAN POUCH FOOD CO., INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A50) is reported at 769 F.2d 1190. The opinion of the district court (Pet. App. A51-A89) is reported at 30 B.R. 1015. The opinions of the bankruptcy court (Pet. App. A92-A107) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on July 30, 1985 (Pet. App. A108-A109) and a petition for rehearing was denied on September 24, 1985 (Pet. App. A110-A111). The petition for a writ of certiorari was filed on December 20, 1985. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Petitioner entered into a contract with the Defense Logistics Agency to produce approximately $22 million worth of combat rations (Pet. 3). The contract included both a "progress payments" provision and a "title-vesting" clause. Under the former, petitioner was entitled to receive payments from the government in advance of delivery.[1] Petitioner received approximately $13 million in progress payments pursuant to this provision (Pet. App. A4). Under the literal terms of the title-vesting clause, title to all parts, materials, inventories, and work in progress acquired or produced by petitioner under the contract immediately vested in the government.[2]

The government terminated petitioner's contract for default after petitioner did not meet production schedules established by the contract (Pet. App. A4). Three days later, petitioner filed a petition for reorganization under Chapter 11 of the Bankruptcy Code, 11 U.S.C. 101 *et seq.* (Pet. App.

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[1]A standard provision regarding progress payments to small businesses is published at 32 C.F.R. 163.79.

[2]The title-vesting clause in the contract provided, in pertinent part (Pet. App. A3):

> (d) *Title.* Immediately, upon the date of this contract, title to all parts; materials; inventories; work in progress; * * * theretofore acquired or produced by the Contractor and allocable or properly chargeable to this Contract under sound and generally accepted accounting principles * * * shall forthwith vest in the Government; and title to all like property thereafter acquired or produced by the Contractor and allocable or properly chargeable to this contract as aforesaid shall forthwith vest in the Government upon said acquisition, production or allocation. Notwithstanding that title to property is in the Government through the operation of this clause, the handling and disposition of such property shall be determined by applicable provisions of this contract such as: the Default clause and paragraph (h) of this clause; Termination for Convenience of the Government clause; and the Special Tooling clause * * *.

A4). The government subsequently filed a complaint in the bankruptcy court to gain possession of the property produced or acquired by petitioner that was allocable to the contract (*id.* at A4-A5). Petitioner filed an answer alleging that the government's legal interest in the property amounted to no more than a lien or unperfected security interest subordinate to the rights of the debtor and other creditors (*id.* at A5).[3]

The bankruptcy court held that the government had title to the property covered by the title-vesting clause and, accordingly, was entitled to immediate possession of such property (Pet. App. A92-A96). Petitioner appealed to the district court, which, after initially ruling that remaining factual disputes prevented entry of judgment in favor of the government (*id.* at A90-A91), ultimately affirmed the bankruptcy court's ruling (*id.* at A51-A85).

The court of appeals affirmed (Pet. App. A1-A33). The court concluded (*id.* at A24) that the government became entitled to possession of all property covered by the title-vesting clause upon termination of petitioner's contract. The court commented (*id.* at A21-A22) that there was "no reason [to] depart[] from the consistent holdings before and after 1958 that the title vesting clause is to be taken literally."[4]

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[3]Petitioner included in its answer, filed January 16, 1981, a counterclaim seeking damages for wrongful termination of the contract (Pet. App. A5, A55). The district court abstained from hearing petitioner's counterclaim on the ground that the claim would be better heard by the Armed Services Board of Contract Appeals (*id.* at A85-A89). The court of appeals affirmed the district court decision (*id.* at A25-A33) and petitioner does not contest this aspect of the lower courts' rulings in its petition for a writ of certiorari.

[4]Judge Swygert, dissenting (Pet. App. A33-A50), contended that the priority of the government's interest in the property in a bankruptcy proceeding should at least in part turn on application of Illinois law. The dissent admitted (*id.* at A49 n.9) that it was "quite likely" that the

ARGUMENT

The decision of the court of appeals is correct, is consistent with decisions of this Court, and does not create a conflict with decisions of other courts of appeals that warrants this Court's review.

1. Petitioner claims (Pet. 11-15) that the decision of the court of appeals is inconsistent with this Court's decision in *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715 (1979). No such inconsistency exists. *Kimbell Foods* concerned the relative priority of contractual liens arising from federal loan programs and in no manner addressed the legal effect of a title-vesting clause in Defense Department contracts. Here, the legal import of the title-vesting clause is plain. "[I]t is * * * well settled that if the contract is such as to clearly express the intention of the parties * * *, and this purpose is expressed in the words of the contract, it is binding and effectual in law to pass the title." *United States* v. *Ansonia Brass & Copper Co.*, 218 U.S. 452, 467 (1910). See also *City of Detroit* v. *Murray Corp.*, 355 U.S. 489, 524 (1958) (Whittaker, J., dissenting).

In *Kimbell Foods*, moreover, this Court looked to the Uniform Commercial Code as a possible basis for resolving the competing rights of the parties only because there was no "federal statute setting priorities" (440 U.S. at 718). In this case, as the court of appeals explained (Pet. App. A9, A10-A16), the appropriateness of a literal reading of the "clear and precise language of the contract * * * grant[ing] the Government title" is confirmed by the relevant statutory backdrop.

In 1958, Congress amended 10 U.S.C. 2307 to authorize progress payments, primarily "to improve opportunities for small business concerns to obtain a fair proportion of

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government would ultimately prevail even under the dissent's "proposed disposition of the case."

Government purchases and contracts." S. Rep. 2201, 85th Cong., 2d Sess. 1 (1958). Progress payments were not expressly sanctioned by statute prior to 1958, but, as the court of appeals found (Pet. App. A16), "the practice of contracting for progress payments in return for title had been followed for many years." Congress did not specifically require continuation of this practice, opting instead for a general requirement of "adequate security" for progress payments (10 U.S.C. 2307(c)).[5] Still, it is appropriate to assume that Congress approved of title-vesting clauses, such as the one in issue here, in light of congressional knowledge of the settled administrative practice[6] and the absence of indicia of congressional intent to the contrary. See *United States* v. *Rutherford*, 442 U.S. 544, 554 n.10 (1979).

Finally, the decision below is consistent with decisions of this Court that have assumed that the title-vesting clause passes title to the government (*United States* v. *Allegheny County*, 322 U.S. 174, 178, 183 (1944); see also *City of Detroit* v. *Murray Corp.*, 355 U.S. 489, 491 (1958) (partial

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[5]The literal terms of 10 U.S.C. 2307(c) refer only to "advance payments" and not to "progress payments" but, as both the majority and dissent below found (Pet. App. A15, A38), "we can think of no reason why Congress could have intended less protection for the Government when making progress payments than when making advance payments." Indeed, the Senate Report on the 1958 legislation discusses Section 305(c) (subsequently codified at 10 U.S.C. 2307(c)) in terms of "the exercise of the proposed advance payment (and progress payment) authority." S. Rep. 2201, 85th Cong., 2d Sess. 8 (1958).

[6]"[A] special task force of experienced [agency] procurement personnel * * * participated in the development of the proposed legislation" and "[t]he bill was screened and approved by all of the affected [federal] agencies * * *." S. Rep. 2201, 85th Cong., 2d Sess. 2 (1958). The Comptroller General, moreover, advised Congress of his view "that the authority to make 'progress' payments should not be provided, unless provision is also made to preserve to the Government the *right to take title* to or receive a lien paramount" (*id.* at 12) (emphasis added).

payments)), and with decisions of lower courts that have in comparable circumstances " 'almost unanimously sustained the [clause] as effecting a full and complete passage of title or ownership, and as not creating only a lien or security interest.' " *In re Double H Products Corp.*, 462 F.2d 52, 55 (3d Cir. 1972), quoting *Boeing Co.* v. *United States*, 338 F.2d 342, 345 (Ct.Cl. 1964), cert. denied, 380 U.S. 972 (1965); *United States* v. *Digital Products Corp.*, 624 F.2d 690 (5th Cir. 1980); *Shepard Engineering Co.* v. *United States*, 287 F.2d 737, reh'g denied, 289 F.2d 681 (8th Cir. 1961); *In re Verco Industries*, 27 Bankr. 615 (9th Cir. 1982). Courts have stressed the special need for immediate government title in Defense Department contracts; the government cannot afford to have title to property necessary for national defense depend on the outcome of protracted commercial litigation (*United States* v. *Digital Products Corp.*, 624 F.2d at 692; see also *In Re Double H Products*, 462 F.2d at 55 n.4).

2. Petitioner erroneously contends (Pet. 16-17) that the decision below presents a conflict with *In re Murdock Machine & Engineering Co.*, 620 F.2d 767 (10th Cir. 1980), and *United States* v. *Lennox Metal Mfg. Co.*, 225 F.2d 302 (2d Cir. 1955), that merits this Court's review. Any inconsistency between either of these cases and the decision below falls far short of that necessary to warrant this Court's attention.

In *Murdock*, the Tenth Circuit held that the government was not entitled to possession of property purchased by the contractor on credit and still in transit from the seller when the contractor filed for bankruptcy (620 F.2d at 768-769). The decision in *Murdock* did not disturb the view that a title-vesting clause passes title to the property to the government. Indeed, the court assumed the clause had that effect (*id.* at 769). The Tenth Circuit's ruling turned, therefore, not on the legal effect of the title-vesting clause (see *id.*

at 775) — the central question in this case — but on unique factual circumstances, involving the special rights of a seller of goods in transit, not present in the instant case.[7]

Similarly, the Second Circuit's decision 31 years ago in *Lennox Metal* does not create a conflict between the circuits requiring this Court's resolution. To be sure, in *Lennox Metal*, the court appeared to suggest (225 F.2d at 317) that the government's interest in the property acquired or produced by the contractor was no more than an equitable lien that could be defeated by the inequitable nature of the government's termination of the contract. In *Lennox Metal*, however, the government's right to possession depended on a clause entitled "Termination for Convenience of the Government," which provided that in the event of its exercise the contractor shall "transfer title and deliver to the government [property] produced as a part of, or acquired in connection with the [contractor's] performance" (*id.* at 316). The Second Circuit's decision that the government was not entitled to legal possession turned, in effect, on the inequitable nature of the government's exercise of the termination clause (*id.* at 317-318).

In the present case, the title-vesting clause took effect "[i]mmediately, upon the date of [the] contract" (Pet. App. A3). The clause was not triggered by some subsequent act of termination by the government. Also, unlike *Lennox Metal* (see 225 F.2d at 318), there is no suggestion in this case that the government's termination of petitioner's contract was tainted by extreme inequity. Finally, it is not even clear that *Lennox Metal* remains good law in the Second Circuit (see,

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[7]Several courts have suggested that *Murdock* is limited to cases involving reclaiming sellers under Article 2 of the Uniform Commercial Code. *Marine Midland Bank* v. *United States*, 687 F.2d 395, 403 (Ct. Cl. 1982), cert. denied, 460 U.S. 1037 (1983); *In re Verco Industries*, 27 Bankr. at 619.

e.g., United States v. *Ameco Electronic Corp.*, 224 F.Supp 783, 786 (E.D.N.Y. 1963)), particularly because the decision predates congressional passage of the 1958 amendment expressly authorizing progress payments. Any possible inconsistency between the circuits based on *Lennox Metal*, therefore, is simply too stale to merit this Court's review.[8]

3. Finally, contrary to petitioner's contention (Pet. 19-23), this case does not present an issue of sufficient importance to warrant this Court's attention. Petitioner asserts (*id.* at 20) that the case involves a fundamental collision between two conflicting policies: (1) "special treatment * * * to the Government [in] the world of private commerce"; and (2) "abhor[rence] * * * of 'secret' liens against property of insolvent estates." No such "collision" is suggested by this case. Indeed, neither *United States* v. *Speers*, 382 U.S. 266 (1965), nor the 1978 amendment to the Bankruptcy Code, both cited by petitioner (Pet. 21), has any bearing on this case. The former involved the relative priority of an unrecorded tax lien, not the power of the government to insist upon immediate vesting of title in its procurement policies; the latter concerned the relative priority of unsecured non-tax debts owed the government, not property owned by the government in the debtor's possession. See H.R. Rep. 95-595, 95th Cong., 1st Sess. 285 (1977).

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[8]Petitioner also suggests (Pet. 19 n.8) that the Court of Claims' decision in *Marine Midland Bank* v. *United States*, 687 F.2d 395 (Ct. Cl. 1982), cert. denied, 460 U.S. 1037 (1983), is inconsistent with the decision of the court below. As petitioner readily concedes (Pet. 19 n.8), however, any theoretical inconsistency between the two decisions does not aid petitioner. Whether the interest of the government is viewed as a vested property right (the opinion of the Seventh Circuit) or as a paramount lien (the view of the Court of Claims in *Marine Midland Bank*) is no matter. Under either view, the government would prevail in this case. Consequently, petitioner's claim does not provide a suitable vehicle to present the issue to this Court. See para. 3, *infra*.

A more appropriate characterization of the issue raised in this case is whether the interest of the government in property acquired or produced by a government contractor receiving progress payments amounts to "title" vested in the government or a "paramount lien" held by the government.[9] In the instant case the label chosen — title or paramount lien — is irrelevant to the result. In either event, petitioner would not be entitled to relief. Under these circumstances, petitioner has raised no important legal issue that warrants this Court's review.

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[9]Even assuming that the literal meaning of the title-vesting clause did not dispose of petitioner's claim, the interest of the government in petitioner's property should, in the alternative, be considered a paramount lien as a matter of federal law. See *Marine Midland Bank* v. *United States*, 687 F.2d 395 (Ct.Cl. 1982), cert. denied, 460 U.S. 1037 (1983). Even the dissent below, which advocated this alternative theoretical framework, agreed (Pet. App. A33, A38) that a federal rule of law would apply (see generally *United States* v. *Kimbell Foods, Inc.*, 440 U.S. at 726) and that 10 U.S.C. 2307 would require that the lien receive priority. The dissent's only dispute concerned whether the state law of perfection should also apply to the government, thereby creating a "hybrid law" with both federal and state elements (see Pet. App. A40). We agree with the majority below (*id.* at A20-A21) that the state law of perfection should not apply. "[A]pplication of state law would frustrate specific objectives of * * * federal programs" (*Kimbell Foods*, 440 U.S. at 728), including the use of progress payments to attract small and minority-owned businesses and the need for immediate government access to property that could be essential to national defense. In all events, however, we note that the dissent agreed (Pet. App. A49 n.9) that even should state law apply, it was "quite likely" that the government would still prevail.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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